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NATIONAL CREDIT UNION ADMINISTRATION

EXAMINER'S GUIDE

Part 2

October 1986

READEX

SUPERVISION POLICY

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SUPERVISION POLICY

1. Supervision Policy

Supervision includes follow-up examinations, review of the semiannual Call Reports (5300s), analysis of the Financial Performance Reports (FPRs), and other specific supervision contacts. All of these contribute equally to effective supervision.

Supervision is always needed in EWS Codes 4 and 5 credit unions and sometimes in credit unions with better ratings. It is the examiner's responsibility to see that the credit union receives the attention needed to fully resolve problem(s). In the early stages, this may mean daily contacts until the examiner is assured that the officials are actively working to solve the areas of concern.

Effective supervision and effective district management are inseparable. One feeds on the other. A properly managed district will almost always, without exception, be effectively supervised. The examiner is knowledgeable about the credit unions in the district, not waiting until a day or two prior to the annual examination to become familiar with a credit union and its condition. The examiner, through various sources such as other examiners, trade association representatives, credit union leaders in the area, news reports, etc., stays abreast of developments within the various industries or communities that may impact on the operations of credit unions in the district. Armed with this and other information (such as the 5300 and the FPR reviews), the examiner acts, rather than reacts, to a potential problem by calling the credit union officials to verify information received, by making an on-site visit to gain first-hand knowledge of the situation or by rescheduling the annual examination.

Informed and responsive district management will usually enable an examiner to deal with adverse developments at the outset rather than after such problems have festered. Effective supervision is results-oriented. Corrective measures are not just agreed to, they are implemented. Problem areas are not just identified, they are solved.

Effectively supervised and properly managed districts will share many common characteristics, but the most important of these will be the fact that the credit unions in those districts will be profitable, well-capitalized, and well-run. With the encouragement and the guidance of the examiner, the officials will have taken strong and aggressive steps to deal with any deficiencies in profit, capital, or operations. Indeed, the status and the direction of the profits, the capital, and the operations of credit unions within a particular district are, to a great extent, a strong, although not the only, measurement of the quality of supervision provided in that district.

2. Follow-up Examinations

Normally, a follow-up examination will be initiated because of a need to review the progress being made on resolving problems identified during an annual examination. (These problems will be reflected in the EWS Code and the problem codes that were assigned.) However, a follow-up examination may be initiated because of conditions

reported on a semiannual Call Report, NCUA 5300, and/or because of information provided by a Financial Performance Report (FPR). A follow-up examination may also be initiated because of a special assignment obtained from the regional director or the supervisory examiner, or because of information obtained from other sources, such as a news release or a telephone conversation with a credit union, a credit union trade association, or the sponsoring organization's personnel.

Follow-up examinations generally are made only in credit unions with serious financial problems to evaluate their progress and, when necessary, to make additional recommendations (which may include administrative actions).

Follow-up examinations are costly in terms of human resources and dollars. Therefore, they must be result-oriented. Simply reporting on the status of the credit union is inappropriate and is not supervision, it is reporting. Supervision is successful when the problems are resolved in such a way that further supervisory efforts are not needed. The most desirable result is correction of the problems, but reorganization or elimination of the entity also is considered a successful alternative where reasonable supervisory efforts cannot resolve the problems due to management resistance or irreversible insolvency. The primary consideration in allocating staff for follow-up examinations will be the risk of liquidation or special assistance that the credit union represents to the Insurance Fund. The risk is a combination of the amount involved (potential payout or special assistance) and the severity of the problem (likelihood that payout or special assistance will be needed). For example, a large credit union could represent a greater risk than a small credit union even if the smaller credit union's problems are more severe.

3. The Purpose of Follow-up Examinations

a. The primary objectives of follow-up examinations are:

(1) Resolve problems; and,

(2) Develop and implement new or revised plans with management that will correct present or emerging problems within a reasonable , but precise, time frame.

b. Other objectives are:

(1) Detect obvious new financial trends which could threaten the credit union's solvency;

(2) Determine the credit union's economic viability and, if not viable, explore merger and liquidation alternatives during the follow-up examination;

(3) Recommend administrative actions when necessary to protect the interests of the shareholders, the creditors, and the NCUSIF; and,

(4) Recommend future supervision plans and contact dates.

4. When to Schedule Follow-up Examinations

Follow-up examinations are typically conducted when:

a. The credit union has been assigned an EWS Code 4 or 5 at the last annual examination. However, other credit unions with a more favorable code should be promptly scheduled for a follow-up examination if the examiner learns of adverse financial trends or of other information that could threaten the credit union's solvency; and,

b. Sufficient time has lapsed since the previous examination to permit the credit union to implement corrective action and to determine results; or,

c. Any unreasonable delay in conducting a follow-up examination could permit rapid deterioration in the credit union's financial condition to go unchecked.

The scheduling of follow-up examinations is dictated by the seriousness of the problems and by the judgment of the examiner.

5. How to Prepare for Follow-up Examinations

In order to ensure that positive results are attained during follow-up examinations, effective pre-examination preparation is necessary. Suggested pre-examination steps include:

a. Reviewing the field file to become reacquainted with the credit union's problems and the information received since the latest examination (such as the FPR, financial and statistical reports, and other written information received from the credit union, the regional office, and the supervisory examiner); and,

b. Contacting key officials in advance to determine that the date of the follow-up examination is understood, that the required records will be available, and that the date and the time of the joint conference are firmly set and notification given to all officials.

6. Guidelines on Performing the Follow-up Examination

Once on-site, the examiner should review all major problems which existed at the previous contact and determine their present status. Particular attention should be given to financial and management problems that could cause failure. This may be accomplished by completing NCUA 2045, Examination Financial Data, and NCUA 2046, Key Ratios, as early as possible after commencing the follow-up examination.

The problems which existed at the conclusion of the previous contact should be analyzed. The current status of each problem must be determined, along with any applicable trend data. Analysis and workpaper preparation during the follow-up examination should be limited to the minimum necessary to adequately document conclusions about all actual or suspected problem areas.

During the contact, any new or evolving problems should be identified. Use of the credit union's financial statements, the NCUA 2045, Examination Financial Data, and the NCUA 2046, Key Ratios, should enable detection of new financial problems.

The examiner will prepare NCUA 2610, Follow-up Examination, to document the status of previously noted areas of concern and any significant problems which may have developed subsequent to the previous contact. Brief narrative comments about each identified problem area should be provided.

Plans of action should be developed with officials to correct unresolved and new problems which are material in nature. The best results usually occur when plans of action are implemented during the contact. It is not necessary to prepare a new Record of Action for an old problem if the plan is being followed and the problem is being corrected. The Record of Action should stress the most important areas first, be properly written, and provide detailed steps for correction of the problems. In addition, the plans of action should be written in clearly understandable steps and should provide reasonable and specific time frames to complete each step.

Problems must be identified and given adequate supervision and direction to prevent the need for financial assistance or to prevent the credit union's becoming insolvent. Detailed plans of action are especially critical in EWS Code 4 credit unions to resolve management problems, loan delinquency, and inadequate reserves. The plans of action must give the officials specific directions to correct severe financial problems. In most cases, plans of action at credit unions coded EWS 5 will be related to merger, liquidation, special assistance, or administrative actions because these credit unions, by the definition of EWS Code 5, cannot correct their own problems without outside assistance.

A joint conference will be held at the end of each follow-up examination to keep management informed of the credit union's EWS code assignment, the status of problems, and the recommended corrective action. All agreements, understandings, and target dates should be specific, and assignments for corrective action should be clearly understood by the persons involved.

Problem credit unions often have problem management. Where the officials have not met their responsibilities, the examiner should take appropriate action, whether it is instruction during the examination, a Record of Action, or a recommendation for administrative action. Removal of credit union management and/or personnel may be one of the alternatives presented to the officials, but any removal action must clearly be the officials' decision. If the board of directors and/or the senior operating management have been given reasonable time frames to correct problems, and the problems remain uncorrected due to inaction or lack of ability, an early recommendation for an appropriate administrative action may be the only solution to dealing with the unresponsive management. Administrative action leading to the removal of officials is described in subsection 4 of the Administrative Actions chapter of this Guide. The examiner should be aware of the drawbacks of removing officials (e.g., no replacements available) and temper the recommendation accordingly.

7. How to Report on Follow-up Examinations

NCUA 2010, Examiner Contact Information, is mandatory for follow-up examinations. A memorandum and other optional workpapers are to be prepared and submitted as necessary in order to document: (1) the identification and the status of problem areas; (2) what was accomplished since the last contact and during the latest contact; and, (3) what is to be accomplished before the next on-site visit. Procedures for assembly and distribution of follow-up examination reports are similar to those followed during regular examinations.

If a request for special assistance is necessary, the forms required for special assistance requests must be completed. Recommendations for administrative actions leading to closure of the credit union should be made in accordance with the Administrative Actions chapter. When requesting the opinion of the regional director regarding a particular issue or problem, a memorandum should always be prepared.

8. Assignment of EWS Codes

EWS Code assignments will be the same as for annual examinations. The Surveillance System chapter discusses the EWS Codes.

9. Reclassification of Problem Credit Unions

Successful supervision will result either in reclassification to a less severe code or to the credit union's being merged, liquidated, or assisted in such a way that further supervision efforts are not needed. The objective of supervision is to minimize the costs to creditors, to shareholders, and to the NCUSIF. There are credit unions that are resistant to supervision due to management weaknesses. These credit unions should be identified early and appropriate administrative action initiated. The following guidelines are provided to aid in determining whether a credit union is misclassified, whether further supervision should be provided, or whether an appropriate administrative action should be initiated.

a. EWS Code 5 - Credit unions should not remain in an EWS Code 5 status for more than 12 months before being reclassified, merged, or liquidated, unless an administrative action is in process.

b. EWS Code 4 - Credit unions should not remain in EWS Code 4 status longer than 12 months, unless:

(1) Administrative action has been recommended or issued;

(2) Special assistance is outstanding;

(3) A merger is being actively pursued; or,

(4) A new financial problem has emerged which is causing the credit union to remain in this classification, even though the initial financial problems have been resolved.

If a credit union has been classified an EWS Code 4 or 5 for more than the specified time frame and the exceptions do not apply, written justification must be provided in the Closed Section or in a memorandum accompanying the report of contact to retain EWS Code 4 or 5 classification. The justification must in detail explain how additional supervision will benefit the members and the creditors and how potential for loss to the NCUSIF will be minimized. It must further explain why administrative action, merger, or liquidation are not appropriate. It must be in the form of a recommendation to the regional director, who will make the final decision on the course of action that will be pursued.

10. Examination Collection of Midyear and Year-End Financial Reports

To ensure the timely and the accurate collection of data, examiners are assigned the responsibility for collecting and for reviewing the semiannual Call Reports, NCUA 5300, for credit unions in their districts. Those credit unions which fail to return a report to the examiner by the due date will be immediately contacted to obtain the report. This follow-up should be made promptly to allow for all edited reports to be returned to the appropriate office within the time frame established by the regional director.

Upon receipt of the NCUA 5300 from the credit union, the report will be reviewed to determine accuracy and completeness. If inaccuracies are discovered, the credit union should be immediately contacted to obtain the correct information. This will usually be performed by telephone but, occasionally, an on-site visit may be necessary. If the examiner questions the validity of the data, the officials should be contacted for confirmation. It is essential that the data entered into the data base be accurate since the NCUA 5300 is the input document for the Financial Performance Report.

Some guidelines for editing certain items or sections of the form which contain frequent errors are identified on the form. During the examiner's edit of the completed Call Report, a comparative analysis of key data should be made. This analysis is directed toward discovery of adverse trends developing since the last on-site contact. These adverse trends could include increasing delinquency; declining assets; declining net income; operating deficits or declining equity position; rapid growth in total shares or loans, especially real estate or commercial loans; and other significant asset structure changes. When adverse trends are noted, those credit unions will be either immediately contacted or given priority in the annual examination cycle.

11. Other Supervision Contacts

There are numerous reasons to contact a credit union. The type of contact and its duration should be geared to produce results.

12. How to Report on Other Supervision Contacts

Other supervision contacts will be reported using a memorandum with supporting workpapers. As a minimum, the report should identify what prompted the contact; the problem; the cause of the problem; the present condition; corrective action(s) completed, initiated or planned; and future plans for supervision. An NCUA 2010, Examiner Contact Information, must be submitted if there is a change in the status of the credit union that should be reflected on the NCUA data base.

Comments should be correct, complete, clear, and concise.

SURVEILLANCE SYSTEM

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SURVEILLANCE SYSTEM

1. Surveillance System

The Surveillance System is NCUA's system to inventory federal credit unions and to identify during examinations those which had problems. Between examinations, adverse trends are detected by means of data submitted by credit unions semiannually on NCUA 5300, Call Report, and by other means, such as the Financial Performance Report (FPR), news releases, special reporting, etc.

The Surveillance System is a management tool used by examiners, by regional directors, and by the NCUA Board. It consists of three stages:

a. Collection of data;

b. Storage of data by computer; and,

c. Distribution of data to staff for analysis.

The data derived from the Surveillance System gives the examiner information which can be used to provide effective supervision and district management. The data provides the regional director information on which to base personnel needs and to measure the progress of credit unions in the region. The NCUA Board uses the information to assist in establishing policy and in taking individual credit union actions (mergers, special assistance, administrative actions, etc.).

1.1 Objectives

Objectives of the Surveillance System are to:

a. Identify credit unions which had existing or emerging problems at the time of examiner contacts;

b. Activate supervision when problems emerge in credit unions between examiner contacts; and,

c. Provide NCUA a measuring instrument with which to gauge credit union performance.

FINANCIAL PERFORMANCE REPORT

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FINANCIAL PERFORMANCE REPORT

1. Financial Performance Report

The Financial Performance Report (FPR) is an analytical tool created for credit union, supervisory, examination, and management purposes. It is designed to provide a 5-year picture of the financial trends and operating results of a given credit union. The data contained in the report may be used as a tool by credit union officials to identify key trends, analyze past performances, and set future goals.

FPRs are computer-generated reports prepared from data submitted by the credit unions for the prior 5 years. Data is updated twice each year from the Call Report prepared by the credit union, NCUA 5300 for federal credit unions and for state credit unions. Data is presented in the form of ratios, percentages, and dollar amounts. The FPR also portrays each credit union in relation to a credit union peer group of similar size and type of membership and provides percentile rankings that show where each credit union stands in relation to other credit unions in key areas of financial performance.

By analyzing the data contained in the report, an examiner may not only obtain an overall picture of a credit union's financial performance but may become aware of possible areas of concern which will require further analysis and investigation.

1.1 Peer Groups

Peer group data is provided as a frame of reference to show how a credit union performed in relation to a group of credit unions with similiar characteristics.

Peer group formation is based on asset size and type of membership. For natural person credit unions, there are several asset size groups and three types of membership - associational, residential, and occupational. Corporate credit unions form a separate peer group and are not distinguished as to asset size. The asset size and the type of membership are shown on each FPR.

Peer averages are computed by adding individual ratio scores and dividing that sum by the number of credit unions in the peer group.

1.2 Percentile Rankings

The percentile ranking shows where a credit union ranks with respect to other credit unions in key areas of financial performance.

To calculate the percentile ranking for a particular ratio, the corresponding ratios (after peer group adjustment when applicable) for all credit unions nationwide are arranged in order from the worst to the best value. A numerical ranking is then assigned

and a percentile calculated. Some ratios are peer group adjusted prior to being ranked nationally. This is to take into account differences between peer groups.

As an example, a peer group of residential credit unions, because of lack of payroll deduction and other reasons, could, as a group, have high delinquent loan to total loan ratios. If ranked with the total population of credit unions, this entire peer group of credit unions would fall at the low performance end of the scale. Therefore, this ratio is peer group adjusted by dividing the credit union's delinquency ratio by the average ratio for the peer group. The resultant ratio is a peer adjusted ratio which reflects whether the individual credit union's performance was better than or worse than the peer group average. In this example, if an individual credit union's delinquency ratio was less than the peer group average, its peer adjusted ratio would be some value less than "one." If its delinquency ratio were higher than the peer group average, then its peer adjusted ratio would be some value greater than "one." The result of this peer group adjustment is to move this particular peer group of credit union population based on how much better or worse than the peer group average the individual peer group members performed.

Of the 10-key ratios displayed on the Financial Comparison, page 2 of the FPR, the following are peer group adjusted: Capital (ratio 5), Expense (ratio 6), Personnel Expenses (ratio 7), Payout Ratio (ratio 8), and Delinquency (ratio 10). The growth ratios (ratios 1, 2, 3, and 4) are not peer group adjusted because a given credit union may change peer groups over the periods under review. The Charge-offs ratio (ratio 9) does not lend itself to peer group adjustment due to the variances in charge-off policy of individual credit unions.

The computation of the overall percentile is a two-step process. First, the individual percentiles for each ratio are added and divided by 10 to obtain an average percentile. Second, the average percentile is ranked with the average percentile for all credit unions nationwide and then sorted to obtain an overall percentile ranking.

A high or low percentile ranking does not automatically imply a good or a bad rating. However, it can provide clues for further investigation into an individual credit union's performance.

2. Format

The year-end FPR is divided into four pages with a mailer page added in front of page 1:

a. Explanatory letter;

b. Financial Comparison;

c. 5-Year Financial History; and,

d. 5-Year Ratio Analysis

The midyear FPR is a two-page report that consists of a financial history and a ratio analysis page. All ratios are annualized where appropriate. The objective of the

report is to provide peer comparisons at midyear and to facilitate trend analysis of financial data over 6-month periods rather than the annual intervals on the year-end report. The report is also useful for tracking progress in financial operations since the last year-end report.

Percentile ranking is not done at midyear because many credit unions do not report midyear data with major expense items and dividends accrued on their income and expense statement. This distorts the key financial measures used in the year-end FPR.

Descriptions of the four-page report are given below.

2.1 Explanatory Letter, Page 1

The Explanatory Letter provides, in columns across the top, the credit union's name and address; charter number and peer group, including the number of credit unions in that group; and region, SE group, district, date of last contact (examination or follow-up examination), and EWS Code. This information should be reviewed for accuracy upon receipt of the report. Any error noted should be brought to the attention of the appropriate NCUA regional office. It is particularly important that the proper type of membership be reported; if an associational credit union is reported as occupational, all of the peer averages shown on the report will be meaningless.

The narrative contains a brief description and use of the various pages of the report. Finally, the letter identifies performance areas and ratios in which the credit union had a percentile score of 25 percent or less in the current year. The purpose of printing low performance areas on page 1 is to aid users in the analysis of the remainder of the report by emphasizing needed review in critical areas.

2.2 Financial Comparison, Page 2

The Financial Comparison lists 10 key ratios for each of the last 2 years, a percentile ranking for each ratio (after taking into consideration peer group differences where appropriate), and an overall percentile ranking.

a. THE 3-YEAR COMPOUNDED GROWTH RATE OF TOTAL INCOME MINUS THE 3-YEAR COMPOUNDED RATE OF OPERATING EXPENSES

*Gross Income - 3 yr less *Total Expenses (Less Div, Int & PLL) - 3 YR

A positive value is desirable on this ratio because it indicates that income is growing faster than operating expense.

b. THE 5-YEAR COMPOUNDED GROWTH RATE OF RESERVES AND UNDIVIDED EARNINGS MINUS THE 5-YEAR COMPOUNDED GROWTH RATE OF ASSETS

*Reserves & Undivided Earnings (Net Worth) - 5 year less *Assets - 5 yr

Reserves provide a cushion against loss loans and should grow in proportion to asset increases. A positive value on this ratio indicates that reserve growth exceeded asset growth.

c. % INCREASE (DECREASE) IN TOTAL SHARES FROM THE PRIOR YEAR

Total savings for the current year less total savings for the prior year divided by total savings for prior year.

A high positive value signifies savings growth which would indicate that the credit union is successfully competing for member savings.

d. % INCREASE (DECREASE) IN TOTAL RESERVES AND UNDIVIDED EARNINGS FROM THE PRIOR YEAR

Retained earnings net of the Allowance for Loan Losses (Regular/Statutory Reserve, Investment Valuation Reserve (state-chartered), other Reserves, and Undivided Earnings) for the current year less retained earnings (net) for the prior year divided by retained earnings (net) for the prior year.

A positive value indicates that the credit union has enhanced its ability to withstand future losses and/or economic downturns.

e. RESERVES AND UNDIVIDED EARNINGS AND SHARES DIVIDED BY SHARES

*Reserves and Undivided Earnings & Savings/Savings

A low value signifies limited retained earnings, which indicates that the credit union has limited ability to protect member savings.

f. TOTAL OPERATING EXPENSES (EXCLUDING INTEREST AND PROVISION OF LOAN LOSSES) DIVIDED BY AVERAGE ASSETS

*Operating Exp less Int and PLL / Average Assets

A low value indicates that the credit union will have more of its earnings available to attract funds and to build reserves.

g. SALARIES AND BENEFITS AS A % OF GROSS INCOME

*Salary and Benefits / Gross Income

Salaries are generally the largest operating expense category and are critical to overall operating expense control.

h. DIVIDENDS AS A % OF GROSS INCOME

*Dividends and Interest on Deposits / Gross Income

This ratio indicates the percent of gross income returned to members as dividends and interest on deposits.

i. NET CHARGE-OFFS DIVIDED BY AVERAGE LOANS

*Net Charge-Offs / Average Loans

Charge-offs are an important indicator of effective or ineffective lending and collection practices. A high value indicates that large loan losses have been recognized.

j. TOTAL DELINQUENT LOANS AS A % OF TOTAL LOANS

*Delinquent Loans / Loans

This ratio is an indicator of delinquency control and potential loan losses.

2.3 5-Year Financial History, Page 3

The 5-Year Financial History displays balance sheet and income and expense data from the Call Report for the prior period and for the preceding 4 years. For certain key ratio data items, the percent changes from one year to the next are shown. The upper and lower boundaries for the percent changes on balance sheet and income and expense categories is 1000 percent. If the range is exceeded, the percent change field is filled with asterisks.

A listing of the data items displayed on the 5-Year Financial History with the appropriate Acct./Code Nos. from the Call Report is contained at the end of this section.

2.4 5-Year Ratio Analysis, Page 4

The 5-Year Ratio Analysis displays groups of financial ratios for the last year and the preceding 4 years. It also shows the peer group average ratios for the most recent year. The financial ratios are listed below. The actual formulas for the ratios are contained at the end of this section.

Commonly used components of many of the ratios are defined separately to avoid further complication of the description of the calculation of the ratios. These commonly used terms are as follows:

AVERAGE ASSETS Total assets for the current year plus total assets for the corresponding period 1 year prior divided by 2.

AVERAGE LOANS Total loans for the current year plus total loans for the corresponding period 1 year prior divided by 2.

AVERAGE INVESTMENTS The sum of all investment accounts for the current year plus the sum of all investment accounts for the corresponding period 1 year prior divided by 2.

EQUIVALENT FULL-TIME EMPLOYEES Number of part-time employees divided by 2 plus the number of full-time employees.

SAVINGS The total of all shares and deposits.

RETAINED EARNINGS The total of the Allowance for Loan Losses, Regular/Statutory Reserve, Investment Valuation Reserve (state-chartered credit unions only), other reserves, and Undivided Earnings.

GROWTH RATIOS (AVERAGE COMPOUNDED GROWTH):

SHARES - 5-YR Total assets for the current year divided by total assets for the corresponding period 4 years prior, raised to the 1/4 power, less 1.

LOANS - 5-YR Total loans for the current year divided by total loans for the corresponding period 4 years prior, raised to the 1/4 power, less 1.

ASSETS - 5-YR Total assets for the current year divided by total assets for the corresponding period 4 years prior, raised to the 1/4 power, less 1.

RESERVES & UNDIVIDED EARN (NET WORTH) - 5-YR Retained earnings for the current year divided by retained earnings for the corresponding period 4 years prior, raised to the 1/4 power, less 1.

MEMBERS - 5-YR Number of current members for the current year divided by the number of current members for the corresponding period 4 years prior, raised to the 1/4 power, less 1.

GROSS INCOME - 3-YR Total gross income for the current year divided by total gross income for the corresponding period 2 years prior, raised to the 1/2 power, less 1.

TOTAL EXPENSES (LESS DIV, INT & PLL - 3-YR The sum of total operating expenses before dividends/interest on deposits less provision for loan losses and interest on borrowed money from all sources for the current year divided by the sum of total operating expense before dividends/interest on deposits less provision for loan losses and interest on borrowed money from all sources for the corresponding period 2 years prior, raised to the 1/2 power, less 1.

BALANCE SHEET ANALYSIS

LOANS/SHARES Total loans divided by total savings.

LOANS/ASSETS Total loans divided by total assets.

NON-EARNING ASSETS/ASSETS The sum of land and building, other fixed assets, and other assets divided by total assets.

RESERVES & UNDIVIDED EARNINGS/ASSETS Retained earnings divided by total assets.

RESERVES & UNDIVIDED EARNINGS & SHARES/SHARES Total savings plus retained earnings divided by total savings.

BORROWINGS/RES & UNDIVIDED EARN & SHARES Total notes and interest payable divided by total savings plus retained earnings.

ASSETS 1 YR/LIABILITIES 1 YR The sum of cash and investments with maturities of 1 year or less divided by the sum of savings and borrowings with maturities of 1 year or less.

OTHER SHARES/ALL SHARES & BORROWINGS Regular savings divided by total savings plus total notes and interest payable.

INCOME & EXPENSE ANALYSIS (% OF GROSS INCOME)

LOAN INCOME (LESS REBATE) Interest on loans (less interest refund) divided by total gross income.

INVESTMENT INCOME Income from investments divided by total income.

SALARY & BENEFITS Employee compensation plus employee benefits divided by total gross income.

INTEREST EXPENSE Interest on borrowed money from all sources divided by total gross income.

OPERATING EXPENSE LESS INTEREST & PLL The sum of total operating expenses before dividends/interest on deposits and transfer to reserves less provision for loan losses and interest on borrowed money from all sources divided by total gross income.

PROVISION FOR LOAN LOSSES (PLL) Provision for loan losses divided by total gross income.

TRANSFER TO STATUTORY RESERVE Transfer to the regular or statutory reserve (net) divided by total gross income.

DIVIDENDS Dividends and interest on deposits divided by total gross income.

NET INCOME Net income (loss) after dividends/interest on deposits and transfer to reserves (net) divided by total gross income.

LOAN ANALYSIS

RESERVE & SURPLUS/LOANS Retained earnings divided by total loans.

DELINQUENT LOANS/LOANS All loans delinquent 2 months or more divided by total loans.

NET CHARGE-OFFS/AVERAGE LOANS Total amount of loans charged off during the year less all recoveries during the year on the charged-off loans divided by average loans.

NET CHRG-OFF/REG RES & RES FOR LOAN LOSSES Total amount of loans charged off during the year less all recoveries during the year on the charged-off loans divided by the allowance for loan losses plus the Regular/Statutory Reserve.

NET CHARGE-OFFS/GROSS INCOME Total amount of loans charged off during the year less all recoveries during the year on charged-off loans divided by total gross income.

MANAGEMENT ANALYSIS:

YIELD ON AVERAGE LOANS (LESS REBATE) Interest on loans less interest refund divided by average loans.

YIELD ON AVERAGE INVESTMENTS Income from investments divided by average investments.

YIELD ON AVERAGE ASSETS Total gross income divided by average assets.

COST OF FUNDS/AVERAGE ASSETS Interest on borrowed money from all sources plus dividends/interest on deposits divided by average assets.

NET SPREAD The sum of total gross income less interest on borrowed money from all sources and dividends/interest on deposits divided by average assets.

OPERATING EXP LESS INT & PLL/AVER ASSETS The sum of total operating expenses before dividends less interest on borrowed funds and transfer to reserves less provision for loan losses divided by average assets.

NET INC BEFORE TRANS TO STAT RES/AVER ASSETS Total net income (loss) after dividends/interest on deposits but before transfer to reserves divided by average assets.

ESTIMATED LOAN MATURITY IN MONTHS Loans outstanding at the end of last year divided by the amount of principal payments made during the year with the result multiplied by 12. The amount of principal payments made during the year is equal to loans outstanding at prior year-end plus loans granted during the year minus the loans outstanding at the end of the current year.

BORROWERS/MEMBERS Number of loans divided by number of current members.

PRODUCTIVITY RATIOS

AVERAGE SHARES PER MEMBER Total savings divided by the number of loans.

AVERAGE LOAN BALANCE Total loans divided by the number of loans.

LOANS/FULL-TIME EMPLOYEES Total loans divided by equivalent full-time employees.

SALARY & BENEFITS/FULL-TIME EMPLOYEES Employee compensation plus employees' benefits divided by equivalent full-time employees.

OPERATING EXPENSE LESS INTEREST & PLL/MEMBERS The sum of total operating expense before dividends/interest on deposits and transfer to reserves less provision for loan losses and interest on borrowed money from all sources divided by the number of current members.

MEMBERS/EMPLOYEES The number of current members divided by equivalent full-time employees.

3. Summary

The FPR should be used by the examiner as a supervision and district management tool both between examinations and during examinations. Between examinations, the FPR provides a means of detecting adverse trends and, thereby, of activating supervision and readjusting examination priorities. During examinations, the FPR serves as pertinent statistical or quantitative data in the examiner's Total Analysis Process.

DATA ELEMENTS ON PAGE 3 OF THE FINANCIAL PERFORMANCE REPORT SHOWING ACCOUNT CODES FROM THE CALL REPORT

Account Name	Acct./Code No.
Assets	
Cash	730
Dep. in S&L	750C
Dep. in Banks	746C
Dep. in Other Cred U	653C
US Govt & Agency Sec.	741C + 742C
NCUSIF Capital Dep	794
All Other Invest	652C + 655 + 743C + 747C - 749
Real Estate Loans	703
Loans to Members	698
Other Loans	001
Total Loans	025B
(Loan Loss Allow)	719
Land and Building	007
Other Fixed Assets	008
All Other Assets	009
Total Assets	010
Liabilities & Capital	
Accounts Payable	800
Dividends Payable	820 + 821
Notes & Int. Payable	011C + 058C + 656C
Other Liabilities	012
Total Liabilities	011C + 012 + 058C + 656C + 800 + 820 + 821
Regular & Other Shares	657 + 890 + 870 + 880
Share Drafts	902
IRA Keogh	906C
Share Certificates	908C
Total Shares	018
Regular Reserves	931
Other Reserves	658 + 668
Undivided Earnings	940
Total Res & Und Earn	658 + 668 + 931 + 940
Total Liab & Capt	014

Income & Expense	
Loan Income	110 - 119
Invest Income	120
Other Income	659
Salaries & Benefits	210 + 220
Total Other Oper Exp	660 - (210 + 220 + 300 + 340)
Non-Oper Income (Exp)	440
Prov for Loan Losses	300
Cost of Funds	380 + 381 + 340
Transfer to Stat Res	019
Net Income	662
Other Information	
High Reg. Share Rate	552
Uns/Auto Loan Rate	560/561 (Highest)
New Money Loaned	031B
Net Chrg Off Loans	550 - 551
Full/Part-Time Empl	564A/564B
Members	083
Members/Potential Members	083/084 (%)
Inv. 1 yr % Total Inv	$\frac{026}{741C + 742C + 743C + 652C + 746C + 750C + 654C + 653C + 747C + 655 - 749}$ (%)
Insured Shares/Total Shares	
Current Year	$\frac{069}{018}$ (%)
Prior Years	$\frac{013 + 890}{013 - (673B - (673A * 100000))}$ (%)

COMPUTATION OF RATIOS
FINANCIAL COMPARISON

Ratios on the Financial Comparison are computed from data on Call Reports, NCUA 5300. The computations are identified below by an "a." The ratios also may be listed on or calculated from ratios on page 3 and 4 of the FPR. These are identified by a "b." The page number and the section where they are located follows immediately after the identifier.

Some figures used in the ratios represent current year's data, while others, as in the case of growth ratios, represent prior years' data. Current year's data is identified by "CY," while each of the prior years is identified by a "CY" followed by the number of preceding years; i.e., CY-1, CY-2, CY-3, etc. Where there is no indication as to year, the data is for the current year.

The result of each computation must be multiplied by 100 to convert to a percentage.

1. Expenses:

   a. $$\frac{100(CY)}{100(CY-2)}^{1/2-1} - \frac{660-300-340(CY)}{660-300-340(CY-2)}^{1/2-1}$$

   b. Page 4, Section I (Total Expenses (Less Div, Int & PLL) - 3 YR) less (Gross Income - 3 YR)

2. Reserves:

   a. $$\frac{719+931+668+940(CY)}{719+931+668+658+940(CY-4)}^{1/4-1} - \frac{010(CY)}{010(CY-4)}^{1/4-1}$$

   b. Page 4, Section I (Reserves & Undivided Earn (Net Worth) - 5 YR) less (Loans - 5 YR)

3. Market Growth:

   a. $$\frac{(013+870+890+(CY) - (013+870+880+890)(CY-1))}{(013+870+880+890)(CY-1)}$$

   b. Page 3, Liabilities & Capital Section (Total Shares)

4. Reserves:

   a. $$\frac{(931+668+658+940+(CY) - (931+668+658+940)(CY-1))}{(931+668+658+940)(CY-1)}$$

   b. Page 3, Liabilities & Capital Section (Total Res & Und Earn)

5. Capital:

   a. $$\frac{013+870+880+89+719+931+668+658+940}{013+870+880+890}$$

   b. Page 4, Section II (Reserves & Undivided Earnings and Share/Shares)

6. Expenses:
   a. $\frac{660\text{-}300\text{-}340(CY)}{(010(CY) + 010(CY\text{-}1))/2}$
   b. Page 4, Section V (Operating EXP less Int & PLL/Aver Assets)

7. Personal Expenses:
   a. $\frac{210 + 220}{100(CY)}$
   b. Page 4, Section III (Salary & Benefits)

8. Payout Ratio:
   a. $\frac{380}{100(CY)}$
   b. Page 4, Section III (Dividends)

9. Charge-offs:
   a. $\frac{550 - 551}{(025B(CY) + 025B(CY\text{-}1))/2}$
   b. Page 4, Section IV (Net Charge-offs/Average Loans)

10. Delinquency:
   a. $\frac{021B + 022B + 023B}{025B}$
   b. Page 4, Section IV (Delinquent Loans/Loans)

COMPUTATION OF RATIOS
5-YEAR RATIO ANALYSIS

Ratios on the 5-Year Ratio Analysis are computed from data on the Call Report. Some figures in the ratios represent current year's data, while others, as in the case of growth ratios, represent prior years' data. Current year's data is identified by "CY," while each of the prior years is identified as CY-1, CY-2, CY-3, etc. Where there is no indication as to year, it is assumed that the data is for the current year.

Growth Ratios (Average Compounded Growth)

1. Shares - 5 YR: $\left(\frac{013+870+880+890(CY)}{013+870+880+890+(CY-4)}\right)^{1/4} - 1$

1) 2. Loans - 5 YR: $\left(\frac{025B(CY)}{025B(CY-4)}\right)^{1/4} - 1$

3. Assets - 5 YR: $\left(\frac{010CY)}{010(CY-4)}\right)^{1/4} - 1$

1) 4. Reserves & Undivided Earn (Net Worth) 5 YR: $\left(\frac{719+931+668+658+940(CY)}{719+931+668+658+940(CY-4)}\right)^{1/4} - 1$

5. Members - 5 YR: $\left(\frac{083(CY)}{083(CY-4)}\right)^{1/4} - 1$

1) 6. Gross Income - 3 YR: $\left(\frac{100(CY)}{100(CY-2)}\right)^{1/2} - 1$

1) 7. Total Expenses (Less Div. Int & PLL) 3 YR: $\left(\frac{600-300-340(CY)}{660-300-340(CY-2)}\right)^{1/2} - 1$

Balance Sheet Analysis

8. Loans/Shares: $\frac{025B}{013+870+880+890}$

9. Loans/Assets: $\frac{025B}{010}$

10. Nonearning Assets/Assets: $\frac{007+008+009}{010}$

11. Reserves & Undivided Earnings/Assets: $\frac{719+931+668+658+940}{010}$

12. Reserves & Undivided Earnings $\frac{013+870+880+890+719+931+668+658+940}{013+870+880+890}$

13. Borrowings/Res & Und. Earn. & Shares: $\frac{656C+011C+058C}{013+870+880+890+729+931+668+658+940}$

14. Asst 1 YR/Liab 1 YR: $\frac{(730+741C+742C+743C+652C+746C+750C+653C+654+655)-741B+742B+652B+746B+746B+750B+653B+747B+026}{(013+870+880+890+011C+058C+656C)-(01B+058B+656B+908C+027)}$

15. Other Shares/All Shares & Borrowings: $\frac{013+870+880+890}{(013+870+880+890+011C+058C+656C)-(011B+058B+656B+908C+906C+027)}$

Income & Expense Analysis (% of Gross Income)

16. Loan Income (Less Rebate): $\frac{110-119}{100}$

17. Investment Income/ Income: $\frac{120}{100}$

* 18. Sal & Benefits: $\frac{210+220}{100}$

19. Interest Expense: $\frac{340}{100}$

20. Operating Expense Less Interest & PLL: $\frac{660-300-340}{100}$

21. Provision for Loan Losses (PLL): $\frac{300}{100}$

22. Transfer to Statutory Reserve: $\frac{019}{100}$

* 23. Dividends: $\frac{380+381}{100}$

24. Net Income: $\frac{662}{100}$

Loan Analysis

25. Reserves & Surplus/ Loans: $\frac{719+931+668+658+940}{025B}$

* 26. Delinquent Loans/ Loans: $\frac{021B+022B+023B}{025B}$

* 27. Net Charge-Offs/Average Loans: $\frac{550-551}{(025B(CY)+025B(CY-1))/2}$

28. Net Chrg-Off/Reg Res & Res for Loan Losses: $\frac{550-551}{719+931}$

29. Net Chrg-Off/Gross Income: $\frac{550-551}{100}$

Management Analysis

30. Yield on Average Loans: $\frac{110-119}{(025B(CY)+025B(CY-1))/2}$

31. Yield on Average Invest: $\frac{120}{((741C+742C+743+652C+746C+750C+654+653C+747C+655)(CY)+(741C+742C+743C+652C+746C 750C+654+653C+747C+655)(CY-1))/2}$

32. Yield on Average Assets: $\frac{100}{(010(CY)+010(CY-1))/2}$

33. Cost of Funds/Average Assets: $\frac{340+380+381}{(010(CY)+010(CY-1))/2}$

34. Net Spread: $\frac{100-340-380-381}{(010(CY)+010(CY-1))/2}$

35. Operating Exp Less Int & PLL/Aver Assets: $\frac{660-300-340}{(010(CY)+010(CY-1))/2}$

36. Net Inc. Before Trans to Stat Res/Aver Assets. $\frac{019+662}{(010(CY)+010(CY-1))/2}$

37. Estimated Loan Maturity in Months: $\frac{025B(CY-1)}{025B(CY-1)+031B-025B(CY)}$ x 12

38. Borrowers/Members: $\frac{025A}{083}$

Productivity Ratios

39.	Average Shares Per Members:	$\frac{013+870+880+890}{083}$
40.	Average Loan Balance:	$\frac{025B}{025A}$
41.	Loans/Full-Time Empl:	$\frac{025B}{564A+(564B/2)}$
42.	Salary & Benefits/Full-Time Employees	$\frac{210+220}{564A+(564B/2)}$
43.	Operating Expense Less Int. & PLL/Member:	$\frac{660-300-340}{083}$
44.	Members/Employee:	$\frac{083}{(564A+(564B/2))}$

* One of the major ratios on the Financial Comparison, Page 2

1) Used to compute one of the major ratios on the Financial Comparison

EXAMINER'S GUIDE

EARLY WARNING SYSTEM

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2. Early Warning System

The Early Warning System (EWS) is a five code rating system for Federal credit unions. The EWS code assigned a credit union is NCUA's method of identifying the seriousness of the problems present in a credit union. Using the standards discussed in this Section, the examiner will assign an EWS code during each contact. The examiner will inform the credit union officials of the recommended EWS code for the credit union prior to concluding the contact. The responsibility for the final EWS code lies with the Regional Director. The examiner will be informed in all cases when the Regional Director changes the EWS code and will be advised as to the reason(s) for the change.

Data submitted by a credit union will not change the EWS code assigned by the examiner. Likewise, the computer will not automatically assign an EWS code.

The EWS code assigned during each annual examination and during follow-up examinations will signify the following:

EWS Code	Condition Reflected by Code
1	Excellent (No major area of concern)
2	Good (Some minor problems, but deficiencies are not material)
3	Fair (Problem(s) exist; further attention is necessary, but probability of failure is remote)
4	Weak (Critical problems exist that could result in liquidation; personal attention by examiner is necessary)
5	Unsatisfactory (Critical problems exist; failure is probable within 12 months)

2.1 Definitions and Descriptions (Judgement Criteria for Assignment of EWS codes)

The definitions of the five-tier classification system are given below. Following each definition is a description of the type of credit union that will be assigned that particular code.

2.1-1 Code 1

Credit unions in this group are basically sound in every respect; any critical findings or comments are of a minor nature and can be handled in a routine manner. These credit unions are resistant to external economic and financial disturbances and more capable of withstanding the vagaries of business conditions than credit unions with lower ratings. As a result, these credit unions give no cause for supervisory concern.

A Code 1 credit union has no major areas of concern. It is soundly operated, has no financial problems, and is not in violation of the laws and regulations which govern the credit union's operations.

2.1-2 Code 2

Credit unions in this group are also fundamentally sound, but may reflect modest weaknesses correctable in the normal course of business. The nature and severity of deficiencies, however, are not considered material; therefore, these credit unions are stable and also able to withstand business fluctuations quite well. While areas of weakness could develop into conditions of greater concern, the supervisory response is limited to the extent that minor adjustments are resolved in the normal course of business and operations continue satisfactorily.

A Code 2 credit union is above average; it could be better, but it has no severe problems. The problems it does have are not material and should be readily correctable without supervision beyond the annual examination.

2.1-3 Code 3

Credit unions in this category exhibit a combination of financial, operational or compliance weaknesses ranging from moderately severe to unsatisfactory. When weaknesses relate to financial condition, the credit unions may be vulnerable to the onset of adverse business conditions and could easily deteriorate if concerted action is not effective in correcting the areas of weaknesses. Credit unions which are in significant noncompliance with laws and regulations may also be accorded this rating. Generally, these credit unions give cause for supervisory concern and require more than normal supervision to address deficiencies. Overall strength and financial capacity, however, are still such as to make failure only a remote possibility.

A Code 3 credit union has problems that need further attention. An example might be a credit union that is operating at a deficit but has enough surplus in its undivided earnings to continue operations for a sustained period (2 years). Other examples might be internal control weaknesses throughout a credit union's operations or serious violations of laws or regulations. In general, a Code 3 credit union has some problems that need attention but the credit union is not expected to fail.

2.1-4 Code 4

Credit unions in this group have an immoderate volume of serious financial weaknesses or a combination of other conditions that are unsatisfactory. Major and serious problems or unsafe and unsound conditions may exist which are not being satisfactorily addressed or resolved. Unless effective action is taken to correct these conditions, they could reasonably develop into a situation that could impair future viability, constitute a threat to the interests of shareholders and/or pose a potential payout or guarantee by the Insurance Fund. A high potential for failure is present but is not yet imminent or pronounced. Credit unions in this category require close supervisory attention and financial surveillance and a definitive plan for corrective action.

A Code 4 credit union has very severe financial problems and/or deliberate violations of laws and regulations. An example might be a credit union that is operating at a deficit without enough surplus to pay a dividend. Code 4 credit unions may well have to liquidate if their problems are not resolved, but the problems are resolvable.

2.1-5 Code 5

This category is reserved for credit unions which have an extremely high, immediate or near term probability of failure. The volume and severity of weaknesses or unsafe and unsound conditions are so critical as to require urgent financial assistance from public or private sources. In the absence of urgent and decisive corrective measures, these situations will likely require liquidation and payout of shareholders or some form of emergency assistance or merger.

A Code 5 credit union will probably fail within 12 months if the deficiencies are not corrected. Failure includes liquidation or merger. Code 5 will be assigned only when the credit union is insolvent or expected to become insolvent within 12 months according to the definition of insolvency in Part 700.1(k)(1) of the Rules and Regulations.

2.2 Recommended EWS Code

Responsibility for assigning EWS Codes is primarily the examiner's. However, for the sake of uniformity and to highlight credit unions which are in certain categories, guidelines for assignment of EWS and problem codes are provided. These are recommended minimums and the examiner always has the discretion of assigning a different code, if justified. The severity of the problem(s) as related to the particular credit union, and the effect it could have upon its future operations must be considered. The EWS Code assigned should reflect the examiner's evaluation of the credit union as related to the definitions of the codes detailed in subsection 3.1 of this section.

The following standards are recommended in assigning EWS Codes:

(1) Probable Asset Share (PAS) Ratio

Code 2 recommended minimum when the PAS is 100 to 102.

Code 3 recommended minimum when the PAS is 100 to 102 and the ratio is declining.

Code 4 recommended minimum when the PAS is below 100.

Code 5 recommended when the PAS is below 100 and the ratio is worsening to the point where the credit union will not continue beyond 12 months.

(2) Special Assistance

Code 3 recommended minimum when special assistance to avoid liquidation has been granted by the NCUA Board pursuant to Section 208 of the FCU Act; the assistance is still outstanding; the credit union has corrected the problems which caused the need for assistance and is following, and will continue to follow, the agreements to amortize the guaranty account or repay a cash advance; and, no additional assistance is anticipated.

Code 4 recommended minimum when the credit union has special assistance outstanding and the problems still remain, but additional assistance is not anticipated.

Code 5 recommended when the credit union either has special assistance outstanding and merger, liquidation, etc., is imminent, or when the credit union is expected to request special assistance, the lack of which would result in merger, liquidation, etc.

(3) Delinquent Loans

Code 2 recommended minimum when delinquent loans exceed irrevocable reserves.

Code 3 recommended minimum when classified loans exceed irrevocable reserves.

Code 4 recommended minimum when classified loans exceed retained earnings.

Code 5 recommended when classified loans exceed retained earnings and there is little likelihood that future earnings can overcome the problem.

(4) Earnings

Code 2 recommended minimum when Undivided Earnings declined during the last full accounting period or quarter, whichever is longer, or whenever operating losses are anticipated.

Code 3 recommended minimum when net losses for the last four quarters have depleted Undivided Earnings by 25 percent or more.

Code 4 recommended minimum when Undivided Earnings are declining at a rate that will deplete them within an 18-month period.

Code 5 recommended when Undivided Earnings are depleted, the likelihood of restoration of profitability is minimal and the credit union will not continue beyond 12 months.

(5) Administrative Actions

Code 3 recommended minimum when administrative action has been recommended or issued due to operational problems, i.e., recordkeeping, compliance, etc.

Code 4 recommended minimum when administrative action has been recommended or issued because of a credit union's financial condition.

Code 5 recommended when a Notice of Intent to Revoke Charter or a Notice of Suspension of Charter has been recommended or issued.

When the recommended minimums suggest different EWS Codes, usually the more severe code will be assigned.

2.3 Examiner Override

In certain situations assignment of a less severe EWS Code than recommended above may be warranted. In these instances the examiner may assign a less severe EWS Code. The reasons for the deviation from recommended minimums should be explained in the Closed Section of the examination report. Examples of situations that may lead to examiner override of recommended codes would be credit unions in operation less than 3 years, or operating losses due entirely to non-deferral of annual expenses. When non-deferral of expenses is the reason for examiner override, the examiner should project the results of operations with proper deferral.

2.4 Problem Areas

Problem areas are used in the identification system to enable the examiner to specifically highlight a problem area. These are assigned at the time of the annual examination and are changed to the extent necessary during follow-up examinations and supervision contacts. The problem areas should reflect conditions as they exist at the conclusion of the annual examination, follow-up examination or supervision contact.

At least one problem area must be assigned when the EWS Code is 2, 3, 4 or 5. Conversely, no problem area may be assigned to an EWS Code 1 credit union. The computer will not accept data that does not conform to these rules.

Good judgement must be exercised in deciding whether or not to assign a problem area. A problem area is assigned when major problems related to safety and soundness exist. There is no hard and fast rule, but appropriate Records of Action usually will be developed whenever a problem area is assigned. Problem area assignment for relatively minor or easily correctable problems should be avoided. Such problems are best treated as exceptions or comments made in the Examination Overview, Examiner's Findings, or Loan Exceptions. As a minimum, the examination report should be clear as to the reason a problem area was assigned, what has or will be done to resolve the problem, and the expected date of problem resolution.

2.5 Workpapers and References

(1) Workpapers

a. NCUA 2010, Examination Input

(2) References

a. Part 700.1(k)(1) - NCUA Rules and Regulations
b. Section 208 - Federal Credit Union Act

COMMUNITY DEVELOPMENT AND LIMITED INCOME CREDIT UNIONS

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COMMUNITY DEVELOPMENT AND LIMITED INCOME CREDIT UNIONS

1. Community Development Credit Unions

The purpose of this section is to provide examiners with policy and procedures for the special activities of credit unions participating in the Community Development Credit Union (CDCU) Program. The program is designed to demonstrate that community-based credit unions, given technical and limited financial assistance, can be positive forces in their community. CDCUs are expected to provide needed financial services to their community members.

1.1 Authority

Part 705 of the NCUA Rules and Regulations implemented in 1980 the initial phase of the CDCU program. Subsequent rules promulated by the Department of Health and Human Services have provided for continuation of the program.

1.2 Objectives

In addition to the objectives stated in the Examination chapter, CDCU examination objectives are to determine compliance with the regulation and to ensure adherence to the intent of the program. An assessment of the credit union's success in meeting the overall objectives of the program should be addressed in the Closed Section under the heading: Community Development Credit Union (CDCU) Program. The assessment should include the credit union's efforts to accomplish the overall program objectives and any items that may have impact on the credit union's ability to meet those objectives. The examiner should also review the impact of the CDCU program's goals and objectives on the credit union's overall operations.

1.3 Community Development Committee

The CDCU regulation requires that a program credit union establish a Community Development Committee. The committee is appointed by the board of directors. The community development committee is required to notify the CDCU's community within 90 days of chartering or conversion. This notice should include the mission of the CDCU, the responsibilities of the committee, the names of its members, and its coordination and community needs function as described in the regulation.

The committee is required to identify community needs, coordinate with other community groups and government agencies involved in community development activities and, within 90 days of chartering or conversion, prepare a Community Needs Plan. The Needs Plan should provide evidence of consultation and coordination with community and government agencies providing services to the community. The Needs Plan should assist the CDCU board of directors to determine action plans and priorities for the credit union's community development activities. The Community Development Committee also reports to the board and the supervisory committee at least quarterly.

The examiner should determine that the Community Development Committee is functioning. The review should include committee meeting minutes, functional reports required by the regulation and any other actions by the board or committee concerning community development activities during the examination period. CDCUs should routinely perform these activities in accordance with the regulation. If the examiner finds that this is not the case, Problem Code C, Compliance, should be cited along with the appropriate persistency designator. Problems identified should be addressed in the Record of Action.

1.4 Capital Assistance Program

Credit unions participating in the program are eligible to receive up to $200,000 from the CDCU capital assistance revolving fund. The capital assistance should be recorded as a nonmember deposit on the books and records of federal and state-chartered credit unions classified as a "limited income" credit union. In credit unions not eligible to receive nonmember deposits, the assistance should be recorded as notes payable or in other applicable accounts.

Nonmember deposits in NCUSIF insured "limited income" credit unions are insured up to $100,000. Accordingly, the credit union should include the nonmember deposit in determining insurable shares for calculating NCUSIF fees and deposit.

The examiner should review the records of the credit union to determine that the capital assistance is recorded properly. The examiner should also review the capital assistance repayment schedule and the credit union's ability to meet the schedule. If it is determined that the credit union is unable to meet the repayment schedule, or if meeting it will cause the credit union liquidity problems, the examiner should address the problem in the Record of Action.

Credit unions receiving capital assistance as notes payable are subject to the 50% limitation on borrowed funds and require an analysis of liquidity. Inadequate liquidity is discussed in the Funds Management section of the Examination chapter.

Participation in the capital assistance program should not distract the credit union from its continuing efforts to promote member shares. The CDCU capital assistance is not a grant and must be returned to the program's revolving fund in accordance with the CDCU regulation.

1.5 Business Plans

CDCUs receiving capital assistance from the program must submit an approved business plan prior to the receipt of capital assistance funds. The regulation requires each CDCU to construct a plan for growth and development of the credit union, including financial growth, credit union development, capitalizations, and the means for achieving these objectives. CDCUs should be encouraged to review and to revise business plans periodically.

2. Limited Income Credit Unions

Credit unions which serve predominantly low income members as defined by Part 700.1(h) of the NCUA Rules and Regulations are commonly referred to as "limited income" credit unions. The regional directors have the responsibility of designating a credit union as serving predominantly low income members. A credit union so designated may accept share deposits from nonmembers as well as from members.

2.1 Limited Income Designation

A credit union may at any time request to be designated as serving predominantly low income members. The request should be submitted to the appropriate regional director. The credit union should also provide information which supports that the credit union's potential field of membership meets the criteria outlined in Part 700.1(h) of the NCUA Rules and Regulations. A proposed credit union may include a request for designation as serving predominantly low income members with its charter application. Supporting information should also be provided.

The district list provided to the examiner each year will identify those credit unions which have been designated as serving predominantly low income members. Limited income credit unions will be examined with the same procedures used for all other natural person credit unions. However, the examiner will review with the officials the information provided in support of the low income designation during each examination of a credit union serving predominantly low income members. Should the examiner determine that the credit union continues to qualify for "low income" designation, it should be noted in the Closed Section of the examination report. Should the examiner find that the credit union no longer qualifies for low income designation, these findings will be reported to the regional director by a memorandum attached to the examination report. The final determination will be made by the regional director and the credit union will be notified accordingly.

3. Supervision

CDCUs and limited income credit unions may require more frequent supervision since they serve predominantly low income members. Particular attention should be given to providing technical advice during the first year of operation.

CORPORATE EXAMINATIONS

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CORPORATE EXAMINATIONS

1. Corporate Examinations

The purpose of this chapter is to provide examiners with examination procedures and policy for the specialized activities of corporate federal credit unions (corporate). The examination procedures in the Examination chapter will be followed during the examination of a corporate unless otherwise stated in this chapter. Corporate examination procedures should also be used during insurance reviews conducted of federally insured state corporate credit unions and CLF reviews of noninsured state corporate credit unions. References in this chapter to compliance with federal law and regulations applies only to federal credit unions. Examiners should familiarize themselves with state law and regulations prior to and/or during the insurance or the CLF reviews.

The most important concept to remember during corporate examinations is that corporate operations and activities are dissimilar to those of a natural person credit union. The same standards used to evaluate activities in a natural person credit union may not be used to evaluate corporates. Rather, examiners must remember that corporates are commercial institutions which must be evaluated in accordance with applicable portions of the Act, the NCUA Rules and Regulations, and the safety and soundness considerations discussed in this chapter.

The sections of the Examination chapter that have been modified or expanded for corporate examinations are:

Guide Section	Subject
2	Pre-Examination Planning (Examination Team)
4	Reserves
5	Profitability
6	Funds Management
7	Management
8	Loan Analysis
9	Investment Analysis
10	Share Structure
11	Cash Analysis
13	Supervisory Committee
15	Regulation Compliance
17	Joint Conference
18	Examination Report

A Corporate Supervision section has also been included.

1.1 Definitions

a. For purposes of section 704.3 of the NCUA Rules and Regulations, a federally insured state-chartered credit union shall be deemed a federally insured state-

chartered corporate credit union when its total dollar amount of outstanding loans to member credit unions plus shares and deposits issued to member credit unions equals or exceeds 75 per centum of its total outstanding loans plus shares and deposits.

b. "Undivided earnings" means all forms of retained earnings except corporate reserves (or regular or statutory reserves, as applicable) and valuation allowances established to meet full and fair disclosure requirements of section 702.3 of the NCUA Rules and Regulations.

1.2 Objectives

In addition to the examination objectives stated in the Introduction to the Examination chapter, the general objectives of a corporate examination are to determine:

a. The degree of market penetration and the ability to meet member credit union needs;

b. The practicality and appropriateness of market strategy;

c. The fitness of management and its policies and procedures; and

d. The ability to qualify as an agent for the Central Liquidity Facility (CLF).

1.3 Pre-Examination Planning (Selection of Examination Team)

The regional director is responsible for selecting the examiner-in-charge for all corporate examinations in the region. The examination team should be comprised of examiners who have previously participated in corporate examinations or in large, complex credit union examinations. When possible, the team should consist solely of supervisory, principal and/or senior examiners. Since only a limited number of examiners are involved in the examination of corporates, the special workpapers referenced in this section have not been distributed but are available at the regional office.

2. Management

One of the primary objectives of a corporate examination is to determine the ability of the board of directors and the executive management to successfully direct and control the credit union's operation. The importance of this area cannot be overemphasized since a corporate is a commercial financial institution acting as a financial intermediary for natural person credit unions and for other related entities in the field of membership. Since most individuals involved as officials or as executive management originate from backgrounds exclusively related to natural person credit unions, it is imperative that decisions made at the corporate level be directly related to commercial practices and procedures. In addition, the examiner must ensure that the objectives stated in the Management section of the Examination chapter are being met.

Since the corporate network holds a pivotal place in the credit union community, management policies and practices will always receive more in-depth analysis and appraisals from peers, members, regulators, and insurers. Therefore, the board of directors and the executive management must manage and operate their corporate with the highest level of management skill and competence available and all related decisions must be beyond the reproach of their membership. The interdependence of corporates and of natural person credit unions and their relationship with insurers demand that all operational and financial management be on a level higher than the minimally acceptable.

2.1 Board of Directors

The examiner will review the background and the qualifications of board members to determine if they are qualified to provide leadership for a commercial-type credit union. The examiner should be able to determine if the board is providing the needed leadership by a review of the following areas:

a. The effectiveness of management policies;

b. The modification of policies when conditions warrant such a change;

c. The board's involvement in future planning through budgeting, projections, and estimates for the future; and,

d. The independence of the board from a league or other organization when making management decisions and policies.

The board of directors must be actively involved in both the policy and the decision-making processes. When it is not involved, long-term difficulties could result. The examiner must determine why the board is dormant and must explain to the directors the pitfalls that follow such an abdication of responsibility.

2.2 Executive Management

The examiner must also evaluate the performance of the general manager. Because of the corporate's commercial aspects, it is important that the examiner take into account the manager's background and qualifications. Corporate problems can often be directly related to the experience of management.

The examiner's evaluation of the board and the management will be discussed in the Closed Section and in other areas of the report as deemed appropriate by the examiner.

2.3 Policies

The board of each corporate must develop adequate policies for all areas of its operation. These policies must be in writing and reviewed at least annually to ensure timely modifications. Board policies should address, but not be limited to, the following areas:

a. Funds Management;

b. Share Strategy;

c. Investments;

d. Lending Program; and,

e. Personnel.

Since board policies provide direction and the objectives to the operational and the financial aspects of the corporate, the examiner will review established policies and will determine that the executive management has instituted proper procedures for implementing those policies. Policies without adequate implementation will not be effective. When reviewing policies, the examiner should make sure that changes have been properly approved and documented. The corporate should establish a policy manual so that it will always have an up-to-date reference.

Since the corporate occupies a unique place in the credit union community, the board of directors should develop a formal written marketing plan/strategy for serving its field of membership. The plan should address how the corporate intends to market its products, to price its services, and to ensure quality products/services and the desired level of market penetration. Since such a plan is ever changing, it should span a 1- or 2-year period, with periodic review and alteration as needed. The examiner should ensure a plan is developed and properly administered during the review and the analysis of all other areas of the corporate's operation.

In addition to reviewing compliance with law and regulation, each examiner should measure the corporate's and its executive management's performances through compliance with policies established by the board.

If policies and procedures are not written or if changes are not properly approved and documented, the examiner should discuss them with the board and prepare a plan of action to correct the problem.

2.4 Board of Directors' Minutes

While reviewing board minutes, particular attention should be given to the directors' attendance at meetings.

In many instances, persons serving on the corporate board reside in locations distant from the credit union. With this situation present, some directors may not regularly attend meetings. Problems can develop when directors abdicate their responsibilities to the remaining directors. If this is the case, the examiner should discuss it with the officials at the joint conference and obtain correction of the problem.

Some corporates have received a bylaw amendment which permits them to conduct board meetings by conference calls for two of the three required board meetings during any quarter. At least one regular board meeting per quarter must be conducted with a quorum of the board physically present. If the conference call meetings are not being conducted properly or if the examiner detects a weakness in management control because of holding these types of meetings, the examiner should discuss these weaknesses with the board.

2.5 Membership Meetings

Section 704.4 of the NCUA Rules and Regulations permits an organizational member (i.e., a member other than a natural person) of a corporate to appoint one of its members or its officials as a representative to the corporate credit union. This representative shall be empowered to attend meetings, to vote, and to stand for election on behalf of the members. No individual may serve as the representative of more than one organizational member in the same corporate.

Location could make it difficult for member credit unions to be involved in corporate affairs. If attendance at membership meetings is poor because of this, the examiner should discuss this matter with the board. The bylaw amendment to permit mail balloting could be the solution to the problem.

2.6 Contracts/Agreements

All contracts and agreements entered into by the corporate during the period of examination will be reviewed. Copies of material provisions of significant contracts and agreements should be included with the examination report.

Special attention should be given to agreements and to contracts entered into by a corporate with another credit union or league for the operation of the corporate. Any contract and/or agreement must comply with applicable sections of the NCUA Rules and Regulations; for example, sections 701.26 and 701.27 concerning service contracts and Credit Union Service Organizations.

When reviewing any contract or agreement, the examiner must determine that any fees assessed to the corporate and/or to the other contractual parties are equitable and not excessive. While most corporates are large in asset size, the volume of work is minimal when compared to a natural person credit union. Excessive fees could have a negative effect on the corporate's financial condition. However, irrespective of the effect on the corporate's financial condition, any payment which cannot be justified by services or goods received will be considered an improper disbursement. Any fee assessed to the corporate must be supported by a schedule identifying the specific

components of the fee (space, personnel, supplies, and so on). The examiner must review the corporate's salary structure and ensure that salaries paid by the corporate for the services of league personnel are supportable.

Any joint operational arrangement or purchase of services by a corporate must be evidenced by a signed contract between the concerns.

2.7 Annual Audit

The supervisory committee of a corporate shall cause an annual audit to be made by an independent, duly licensed CPA and shall submit the audit report to the board of directors. A summary of the audit report shall be submitted to the membership at the next annual meeting.

Examiners should expect the hired auditor to do more than just certify the numbers when the audit uncovers areas which the board should address to resolve or to prevent operational or financial problems. If the CPA firm fails to adequately address all concerns, the examiner should discuss this situation with the supervisory committee and the board of directors and the report should reflect these discussions.

During the analysis of the auditor's work, the examiner will pay particular attention to the auditor's review of internal controls and of operational procedures. If these areas were not reviewed by the auditor, the examiner will address these deficiencies in the Examiner's Findings or as a Record of Action, as appropriate.

A copy of the audit report shall be submitted to the appropriate regional office of the National Credit Union Administration within 30 days after receipt by the board of directors. During the review of the audit work, the examiner will verify that a copy of the audit report has been sent to the appropriate regional office. If the report has not been sent, the examiner will include one with the examination report.

Upon receipt of a corporate audit report, the regional director is responsible for having the report scanned for any serious problems. After the report is reviewed, the report will be sent to the district examiner. If the regional office requests supervision from the district examiner, the audit report should be forwarded through the appropriate supervisory examiner.

2.8 Program/Services

Pursuant to section 120(a) of the Act, and subject to other applicable provisions of law, regulation, bylaws, and any orders of the NCUA Board, a corporate may provide to its members services involving investments, liquidity management, payment systems, and correspondent services.

Since this section grants corporates the power to offer innovative programs and services to their members, each corporate has the duty and the responsibility when developing these new programs to ensure that all steps are taken to protect itself and its members who use the services.

During the examination, each program/service will be reviewed to ensure its propriety and its sound operation. Exceptions will be noted in the report and, as appropriate, discussed with the board of directors. Serious problems will be covered in the Record of Action.

2.9 U.S. Central

Since each corporate directs investments and other funds to the U.S. Central, it is imperative that each develop a good working relationship with the U.S. Central and vice versa. Most, if not all, programs and services commence at the U.S. Central level, as well as other corporate groups; therefore, a professional and a credible relationship must be nurtured by the officials.

The free exchange of ideas, philosophy, and concepts from the natural person credit unions through their corporate credit unions to the U.S. Central will enhance the overall efforts of each group in fulfilling its members' needs. During each examination, the examiner should be alert for signs of problems developing in this relationship and, as warranted, should discuss the situation with the board of directors to ensure resolution of the problems.

3. General Ledger Review and Objectives

The General Ledger review and analysis procedures for natural persons credit unions, as detailed in section 3 of the Examination chapter of the Examiner's Guide, will be followed to the extent possible in corporates. The size, the nature, and the regulation differences for corporates require a unique or an expanded consideration in certain key areas as discussed below.

During this analysis the examiner will prepare a Comparative Statement of Financial Condition, NCUA-CCU1, and a Comparative Statement of Income and Expense, NCUA-CCU2.

3.1 Cash Analysis

The examiner must determine that the corporate is analyzing its cash flow and its sources and uses of funds by reviewing its most recent comparisons of receipts and disbursements. Most of the corporates should be analyzing cash flow at least daily. However, it is not enough for management to know only the previous day's beginning cash balance, cash receipts, cash disbursements, and ending cash balance. Management should also have a schedule identifying the types of receipts, i.e., daily shares, jumbo certificates, membership shares, borrowed funds, short-term loan repayments, and long-term loan repayments; and the specific uses of the disbursements, i.e., short-term loans, long-term loans, daily share withdrawals, jumbo certificate withdrawals, daily investments, and expense payments.

Without this information, management cannot properly control its funds management program. The volatility of the cash flow in the corporate requires the board

of directors to develop a budget for cash flow, for sources and uses of funds, and to measure actual performance against such budgets at least quarterly. The examiner should review the corporate's work in this area for the last quarter to ensure the accuracy of actual and budgeted figures and to determine if any adverse trends are developing. The examiner must remember that these budgets and the cash flow schedule can be in varying forms. A review of the board's minutes may assist the examiner in determining that the board of directors' requirements and sound business practices are met.

3.1-1 Internal Controls

The examiner will review the flow of funds through its various stages (i.e., receipt, deposit, and disbursement). A flow chart or a narrative description will be prepared by the examiner during this review. This flow chart can be updated from year to year during the examination.

Most corporates transfer and receive funds via wire transfer. The examiner will review this area to determine if the person(s) authorizing fund transfers also has responsibility for recording the transfers in the credit union's records. These functions should be performed by separate parties. If the examiner finds that this is not the case, the matter should be addressed in the Examiner's Findings.

3.1-2 Federal Reserve Terminals

Corporates are now using Federal Reserve Terminals in an effort to improve efficiency and to reduce wire transfer costs. After the corporate establishes a federal reserve account, it can use these terminals to move funds immediately to and from other financial institutions that have established Federal Reserve accounts. The examiner must determine that adequate internal controls have been established to guard against unauthorized transfers. Procedures should be in place that require verification of all transfers daily. This procedure is important since the correction of unauthorized or incorrect transfers can be delayed for an extended period because of the complexity of the system.

To assist in analyzing this area, the examiner may utilize the Wire Transfer Questionnaire. The questionnaire should be used as a guide and an appropriate modification may be needed to tailor the questions to the particular credit union being examined.

3.2 Investment Analysis

The review of the corporate's investment portfolio will be extensive since investments usually comprise the major portion of the corporate's assets. If the investment portfolio is not properly managed, both the earnings and the liquidity position could be adversely affected. All investments will be fully analyzed and documented on the appropriate workpapers.

3.2-1 Policies

The corporate must establish written investment policies as required. As a minimum, these policies will address the following:

a. Objectives - In developing investment objectives, the corporate should emphasize safety and liquidity over yield;

b. Legality - Sections 107(7) and (8) of the Act and section 703.3 of the NCUA Rules and Regulations list the legal investments available. If the board decides to limit its investing to certain specific legal investments, they should be listed as part of the policies;

c. Diversification - The board should establish the types of investments and maturity limits and the amounts to be invested in each type;

d. Liquidity Needs - The corporate should use its budgetary process to determine the investment portfolio needed to meet present and future liquidity needs;

e. Risk - The policy should specifically address market risk, interest rate and maturity risk, credit risk, and price-level risk;

f. Marketability - The board policy should specifically detail the interest marketability problems/advantanges in each type of investment;

g. Accountability - The policy should specifically address any investment authority delegated to a committee or an individual; and,

h. Safekeeping - The policy should explicitly detail all methods of holding various securities in-house or with other institutions.

A more detailed discussion concerning investment policies and safekeeping appears in the Investment Analysis section of the Examination chapter.

3.2-2 Internal Controls

NCUA 2390, Investment Internal Controls, should be completed during the review of the investment program.

In addition to the internal control areas discussed on NCUA 2390, the examiner must also determine:

a. That there is a clear segregation of responsibilities between those individuals who authorize investments, who physically invest or divest funds, and who post investment records;

b. That all investment transactions are incorporated into the board minutes, regardless of whether authority to invest has been delegated to an executive or to an investment committee;

c. That an executive or an investment committee is preparing minutes, which are providing detailed information for all actions approved by them; and,

d. That before doing business with a broker, the board evaluates the firm on its reputation, its financial strength, and its years in business.

3.2-3 Assignment of Securities

The corporate network has developed several programs over the years aimed at allowing member credit unions to increase yield on investments, at using investments as collateral for loans, and at providing a safekeeping service. While NCUA has taken a neutral stand on the benefit of these programs, the corporate network, nonetheless, has requested that NCUA review some programs. As originally presented, the programs meet, at least, minimal criteria for legality and safety. Since these programs do change, the following listing should not be considered all inclusive. The program currently in use is discussed below:

Security Services Program (SSP)

This program provides credit unions with safekeeping services, with more timely coupon and principal collection on government securities, with an additional source of liquidity, and with an opportunity to leverage securities through reverse repurchase transactions for increased yield and to provide collaterized investments to credit unions desiring an investment which is backed by government securities.

a. The Security Safekeeping Program (SSP) offers safekeeping services to credit unions holding United States Government and federal agency securities. This covers traditional custodial services such as monthly safekeeping reports, coupon and principal collection and other maintenance services.

b. The Security Liquidity Program (SLP) gives credit unions a line of credit in an amount approximating the market value of eligible securities it transfers into the program.

c. The Reverse Repurchase Transactions (RRT) program involves a reverse repurchase transaction representing the sale of a security for a "price" with a simultaneous commitment by the seller to repurchase the security at some future date at a specific "price." Interest earned during the period of this transaction is passed back to the registered owner. Generally, the proceeds of this program must be invested in a corporate account or in a certificate of equal amount and maturity.

d. The Collateral Investments (CI) program allows credit unions to secure their investments in the corporate with United States Government and federal agency Securities. Under this program, the corporate will "sell" to the investing credit union the securities via a repurchase transaction.

3.2-4 Review of Securities

During each examination of a corporate which engages in the above investment programs, the examiner will summarize the following information in the Supplementary Facts section of the report:

a. Par value of securities assigned to the corporate;

b. Current market value; and,

c. Outstanding loan balance.

The examiner should also be alert to the development of similar programs by other corporates. If other programs are discovered, the procedures and the descriptions relating to the programs will be included with the examination report. The examiner should refrain from commenting on the legality and the safety and soundness of the program until it has been reviewed. However, comments should be made in the Supplementary Facts section about the program and that NCUA will review it. The examiner will submit all pertinent information, including a specific recommendation concerning the new program, to the regional director, along with the examination report.

3.3 Reserve Analysis

The analysis of reserve accounts will depend upon the field of membership of the corporate and its involvement with natural person accounts.

3.3-1 Corporate Reserve and Regular Reserve

The examiner will determine that the corporate is complying with the percentage transfer requirements of section 704.3 of the NCUA Rules and Regulations regarding the maintenance of a Corporate Reserve, Account Number 935.

Section 704.3 concerns the establishment and the maintenance of a corporate reserve against loan losses and certain investment losses. For corporates, this section applies in lieu of section 702.2 of NCUA's Rules and Regulations. For federally insured state-chartered corporate credit unions, this section applies to the extent that applicable state law and regulations (1) require the transfer of a lesser amount to reserves for loan and investment losses than this section or (2) allow charges to reserves for other than loan and investment losses as permitted by this section.

At the end of each dividend cycle and prior to paying a dividend (or, at the option of the corporate, on a monthly basis if dividends are paid more frequently than monthly), sums shall be set aside in a Corporate Reserve in accordance with the following schedule: (1) When the credit union's Corporate Reserve and undivided earnings are less than 2 percent of assets at the end of the transfer period, the corporate shall set aside an amount equal to .0015 times its average daily assets for the transfer period

times the number of days in the transfer period divided by 365. (2) When the Corporate Reserve and the Undivided Earnings are equal to or greater than 2 percent of assets but the Corporate Reserve is less than 4 percent of assets, the corporate shall set aside an amount equal to .0010 times the credit union's average daily assets for the transfer period times the number of days in the transfer period divided by 365.

Charges may be made to the corporate reserve for loan losses and for investment losses caused by factors other than trading losses or market fluctuations. No other charges shall be made except as may be authorized in writing by the NCUA Board or its designee. Charges shall be made in accordance with full and fair disclosure requirements as described in the Accounting Manual for Federal Credit Unions.

If the corporate is making loans to natural persons, or has risk assets as determined by section 700.1 of the NCUA Rules and Regulations, the examiner will determine that the corporate is also maintaining a Regular Reserve, Account Number 931. The review of this account should be made in accordance with the examination procedures set forth in the Examination chapter.

The examiner will prepare a workpaper for each reserve and undivided earnings account. While NCUA form 2220 may be used to document this analysis, the examiner is free to use a self-designed workpaper.

3.3-2 Allowance for Loan Losses

The procedures for reviewing the Allowance for Loan Losses will be the same as those for a regular examination. The examiner will complete NCUA 2210, Allowance for Loan Losses.

The officials must comply with section 702.3 of the NCUA Rules and Regulations by estimating the potential losses for corporate loans and then providing for the potential losses in the Allowance for Loan Losses account. The balance in the Allowance for Loan Losses should be sufficient to provide for all potential losses in the loan portfolio. If one or more of the following conditions are applicable to a corporate member's outstanding loan, the loan should be considered a potential loss and should be accounted for in the allowance account:

a. Principal payment is 60 days or more past due;

b. Interest payments are 90 days or more past due. If the member is not meeting the terms of the loan in regard to payment of interest, the possibility exists that the member is having financial difficulties. The examiner should review the member's latest financial statement and compute the creditworthiness criteria in section 5 of this chapter before requiring the Allowance for Loan Losses to be increased. If there is no current financial data on file (data within the past 90 days), the examiner should ensure the Allowance covers the entire loan balance; or,

c. The member credit union has entered liquidation. Although the loan may be to a member which is insured by NCUA or by a state insurance fund, this does not guarantee that the corporate will not sustain a loss. The examiner should contact the

regional office or, if authorized, the state credit union supervisory authority to determine if there are sufficient assets to pay all creditors. If the remaining assets are not sufficient to cover the loan balance or if the examiner is unable to determine the current status of the liquidating credit union, the Allowance for Loan Losses should be adjusted to cover the potential loss.

3.3-3 Equity Strategy

During the examination, the examiner should determine that the board of directors has a formalized plan/strategy for continually building the corporate's equity base (revocable reserve, irrevocable reserves, and unappropriated retained earnings) and that the strategy is being followed.

The corporate network's extreme susceptibility to market fluctuations, good and bad, places increased importance on the more stable items on the balance sheet. These stable assets are the corporate's protection against a complete outflow of shares. Most corporates are striving to increase their equity base to a level that will sustain all its operational expenses during bleak times. A Break-even Analysis workpaper may by used in analyzing this area.

3.4 Share Structure

The share structure of a corporate is quite different from that of a natural person credit union in that shares invested in a corporate are usually short term and are subject to market conditions. Therefore, the review of this area is important when related to the overall operation.

3.4-1 Deposits by Corporates in Other Corporates

The examiner should be alert to methods used by corporates to circumvent the 50 percent borrowing limitation for federal credit unions. This circumvention can be achieved by using nonmember share accounts and jumbo share certificates. Another method used is the purchase of jumbo certificates by another corporate from the corporate.

When the examiner believes the corporate may be trying to circumvent the regulation, two notes payable ratios should be computed - one in the usual manner and another reflecting the other corporate's shares as notes payable. If the notes payable ratio reflects abnormally high illiquidity, this should be commented on in both the open and the closed sections of the report and be discussed with the officials at the joint conference. The examiner must be alert to other methods that might be employed by a corporate to circumvent the borrowing limitations by using shares.

3.4-2 Share Accounts

The commercial nature of the corporate and its efforts to adequately serve its members' needs have given rise to many variations of the share account and the share

certificate. Some such accounts are: daily share account, corporate share drafts, membership shares (formerly permanent capital base), share certificates (a large variety), and overnight-type accounts.

During the examination, the various share and share certificate accounts should be reviewed to determine the appropriateness of each.

4. Funds Management and Objectives

Funds management is critical to the operation of a corporate because of the rapid movement of funds within the operation. If a corporate is not prepared to effectively deal with changes in its asset and liability structure, it could be faced with severe liquidity problems and the NCUSIF risks would increase correspondingly.

The examiner should review the Funds Management section of the Examination chapter of the Examiner's Guide and section 7000 of the Accounting Manual before beginning this review in the corporates.

4.1 Budgetary Process

The corporate must follow safe and sound business practices in developing its funds management approach. There are three essential operational items that form the basis for this development. They are income and expense, cash flow, and sources and uses of funds. In the review of the budgetary process, the examiner must review the corporate's actual and budgeted figures pertaining to the sources and the uses of funds. The review of cash flow and of income and expense is discussed in other parts of this chapter.

4.2 Application of Funds Management

The examiner must analyze how the corporate applies funds management to its operation. This can best be accomplished by determing how the corporate:

a. Uses the information obtained through the budgetary process. The examiner will review the actual and the budgeted figures for the two quarters prior to the effective date of the examination. The examiner must then determine if changes were made based on this information and, if so, that the changes were related to all segments of the operation. A potential weakness can occur when a policy change is made based on one factor without associating the change to the other segments of the operation.

If the information obtained is not being used, it should be discussed with the board because of the possible adverse effects if not corrected.

b. Forecasts future needs. The examiner must determine how the corporate arrives at projections. Forecasts are based on historical data and it is recommended that projections be based on at least 5 years of past operation, when possible. Forecasting is essential to the maintenance of adequate liquidity.

c. Analyzes the balance sheet in terms of maturities and yields between the asset and the liability accounts. The examiner will review asset and liability accounts to determine if management is matching the maturities and the yields of these accounts. Special attention should be given to the corporate's funds position for maturities of 180 days or less. If there is a negative position, a liquidity problem may be indicated. A funds management form is available to use in analyzing the maturity structures of the assets and the liabilities of a corporate credit union.

In addition to analyzing the corporate's current position, the examiner should analyze previous periods for no more than 1 year by using the month-end information for each quarter. Managers often match maturities but spend little time in analyzing yield differences. Analyzing yields, referred to as spread management, is a technique which is important because of the various types of share accounts available and because of a changing economy.

d. Determines what method of funds management to use. The basic methods are asset management, liability management, spread management, and gap management. These methods are discussed in the Accounting Manual.

Since funds management is so important to the corporate's operation, it will be a standard agenda item to be discussed at joint conferences. If problems or potential problems exist because of the lack of funds management, the examiner will develop a Record of Action. A discussion of the problem will be included in the Closed Section.

4.3 Income and Expenses

Income and expenses will be analyzed to ensure that the corporate is properly accounting for expenses and for income. In addition, the examiner will determine that the board is documenting the approval of expenses and is comparing the budgeted amounts to actual performance. The comparison analysis should be included in the board minutes. Depending on the size of the corporate, it could be advantageous to make the review monthly. If there is a need for this comparison monthly, it should be recommended to the board and the management at the joint conference and in the open section of the report, as appropriate.

During this analysis, the examiner will carefully review all income and/or expense items which are contracted for between the corporate and the league. In view of the corporate's unique position in the credit union industry, it must maintain all transactions with the league above reproach and in keeping with its fiduciary responsibility. If the examiner believes a problem may exist, the supervisory examiner and the regional office should be consulted before making a final determination. If a serious deficiency is noted, it will be addressed in the Overview, the Closed Section, and the Record of Action, as appropriate.

5. Loan Analysis and Objectives

The review of loans to member credit unions and the related analysis of lending policies and practices will comprise a major aspect of the overall evaluation of a

corporate's financial condition. In addition to the objectives listed in the Loan Analysis section of the chapter, the examiner's objectives during the analysis of the corporate's loan program will be to determine if:

a. Member credit unions' loan requests are adequately reviewed for creditworthiness;

b. Loan policies, practices, and procedures treat all members equitably;

c. Lending policies and practices for corporate lending are related to current market and economic conditions; and,

d. Agent members of the CLF are complying with CLF loan creditworthiness criteria and procedures.

5.1 CLF Lending

There are three types of loans made by the CLF which can be related to corporate lending, especially if the corporate is an agent for the CLF.

a. Short-Term Adjusted Credit - This type of loan is usually for 90 days and is made to meet temporary outflows of funds.

b. Seasonal Credit - This type of loan is self-explanatory and it usually has a maturity of 9 months or less.

c. Protracted Credit - This is a long-term loan, usually for more than 90 days and not more than 4 years, which has been granted because of unusual or emergency circumstances faced by the credit union.

With the exception of LICU and Central Credit Union Fund, Inc., which are not affiliated with the U.S. Central, all corporate credit unions are agents of the CLF. As such, member loans can be obtained, within specifically defined parameters, from the CLF through the local corporate. Naturally, any such loans must meet the CLF's lending criteria.

5.2 Lending Policies

The examiner must review in detail and become familiar with the board's loan policies. When reviewing policies, the examiner should pay particular attention to:

a. Loan Limits - Written limits must be established for secured and unsecured lending and be realistic when related to principles of sound loan portfolio diversification.

b. Terms and Maturities - Terms and maturities should be appropriate for the needs of the borrowing credit union and should fit within the corporate's overall funds management policy. Terms and maturities must be in writing and, at a minimum, provide

that a payment be made at least annually and be sufficient to retire the note within 12 years for each type of loan, including demand notes and lines of credit. Some corporates have been issuing loans which are payable on demand but in actual practice remain outstanding indefinitely. Such a procedure is a sign of poor funds management and violates the NCUA Rules and Regulations, which require payments sufficient to pay the loan in full at maturity.

c. Interest Rates - The examiner will determine that the interest rates charged by the corporates for loans are within the limitations of section 701.21(c)(7) of the NCUA Rules and Regulations. However, if the corporate is an agent for the CLF, section 307(16) of the Act gives it the authority to charge the member credit union the same rate that the CLF is charging its members.

5.3 Lending Practices

The review of the corporate's lending practices must focus on the evaluation of member credit unions' creditworthiness. Loans to credit unions are considered commercial loans; therefore, the corporate should evaluate the total operations of borrowing member credit unions to determine that they have the ability to repay as required by section 701.21 of the NCUA Rules and Regulations. If the examiner finds during the analysis of loan applications that the corporate is not following either sound business practices or the NCUA Rules and Regulations, a Record of Action should be prepared and the facts should be presented in the Overview. Failure of the corporate to develop standards for the evaluation of creditworthiness can be considered an unsafe and unsounnd business practice in conducting business, which violates section 206(b)(1) of the Act.

In order to properly evaluate a borrowing credit union's condition, the corporate should:

a. Obtain financial and operational data, including, but not limited to, balance sheets; statements of income & expense; statistical information, including aging of delinquency; and Supervisory Committee Audit Report; and,

b. Analyze financial and operational data by calculating selected key ratios to determine the borrowing credit union's financial soundness. As a minimum, the following ratios should be calculated and retained in the loan file: loan to share, expense to income, delinquent loans to total loans, loss ratio since organization, statutory reserves to loans, government obligations and federal agency securities to assets, notes payable to shares, and asset-share ratio (cash value of assets less liabilities to shares).

The ratios should be compared with peer/national averages for similar size credit unions. In addition, management should have a policy defining certain ratio tolerances, which would require specific pledges of acceptable collateral or would be disapproved. These ratios and the analysis by the loan officer or the credit committee should be on a workpaper which remains in the loan file. The analysis should also indicate whether the loan request was analyzed with respect to amount, purpose, cost, and plans for repayment and that the request is consistent with prudent borrowing practices.

While the board of directors establishes acceptable credit standards within the applicable legal limitations and sound business practices, credit unions showing unacceptable ratios or declining trends warrant in-depth analysis if not outright denial of the credit extension.

The financial analysis review of the borrowing credit union by the corporate cannot cease once a loan or a line of credit is approved. The corporate must establish a system which provides for a continuing review of each borrowing credit union's financial condition. The corporate should require each borrowing credit union to submit at least quarterly financial reports that include statistical information and which show the aging of delinquency. Upon receipt of the data, the ratios discussed previously should be calculated and entered on a trend analysis worksheet. If a member applies for a line-of-credit advance or for an additional loan, this information should always be requested regardless of when the latest reports were received, unless the latest information is less than 1 month old. If a member credit union does not provide financial information as required, additional loan advances should be withheld.

Once these standards and policies are established, management should determine that they are applied in all cases. The analysis and the evaluation of the borrowing credit union's financial condition and trends must be a routine procedure and be integrated into the day-to-day operation of the corporate to assure the maintenance of a sound loan portfolio.

c. Obtain complete loan documentation, including:

(1) A resolution from the board of directors of the member credit union authorizing the borrowing of funds; and,

(2) A fully completed note and a loan application for each loan. If the credit union has a line of credit, there should be a fully completed advance request on file for each advance. If the member has more than one loan outstanding, each loan must be supported by the member's board resolution, note, loan application, and any other related documents.

The loan documents used must satisfy the legal requirements of the state in which the corporate is located. If a legal opinion is not on file, the examiner should encourage the officials to obtain one and should treat the matter in the Examiner's Findings.

All loans or advances must be properly approved and evidence of such approval must appear on each request. Any omissions should be listed as a loan exception on NCUA 2120, Loan Exceptions.

5.4 Number and Selection of Loans To Be Reviewed

The following categories of loans to member credit unions (corporate loans) will be reviewed during each corporate examination. If information developed during the review indicates that a serious problem exists, the examiner has the option of expanding

the review as necessary. Reasons for expanding the loan review will be discussed in the Closed Section of the report.

a. Current Loans - Using the random sampling technique, the examiner will review and, as warranted, will profile a sufficient number of loans to ensure that existing credit policies and sound lending practices are being followed. If the corporate is using a personal computer program to develop the data on credit extensions, on original loans, and on subsequent advances/renewals, the examiner, after performing sufficient test checks to ensure the reliability of the data and of the calculations, may utilize the computer-developed data in the review of current loans. Copies of this data should be included in the examination report in lieu of profile sheets. A minimum of 10 loans granted at least 6 months prior to the examination will be checked for delinquency. These loans should be randomly selected.

b Large Loans - Profile and review all loans that have an outstanding balance greater than 1 percent of the corporate's assets as of the effective date of the examination.

c. Loans to Officials' Credit Unions - Profile and review all loans that fall into this category.

d. Loans to Credit Union Leagues and Other Affiliated Credit Union Organizations - Profile and review all loans that fall into this category to determine if preferential treatment exists in the granting of credit and if the organization is creditworthy. In the past, preferential treatment has been extended to these types of organizations because of the close affiliation between the officials of the corporate and the league or other organizations. If this condition exists, the examiner will discuss it with the board of directors; will schedule the preferential loans on NCUA 2120, Loan Exceptions; and will prepare a Record of Action for correction of the problem.

e. Charged-Off Loans and Delinquent Loans - Profile and review all loans which fall into this category. The profile of these loans should be completed prior to profiling current loans. If these types of loans are present in the corporate, the analysis of their significant adverse characteristics is extremely important because the examiner should be able to determine if the same adverse characteristics are present in current loans.

f. Loans to Natural Persons - If the corporate is making loans to natural persons, these loans will also be reviewed.

5.5 Corporate Loan Profile

If provided for in the loan contract, a corporate is authorized to assess prepayment penalties on loans made at fixed rates and for specified maturities to member credit unions or to other organizations.

Loans to member credit unions and organizations, selected under the criteria established above, will be profiled on NCUA 2238, Corporate Central Loan Profile. The instructions on the reverse of the form will be followed.

The examiner should prepare a summary of the loan review data and profiles if the information would be beneficial in the evaluation of the corporate's loan portfolio.

The primary purpose of the loan review is to determine that the corporate has sound credit policies and practices and continuous internal review and control. If the loan review shows that the credit extensions are sound, it could be the result of having only good credit unions borrowing at that time and not the result of the corporate's credit policies and practices.

The corporate's unique characteristics will result in periods of high or low loan demand. During these fluctuations in loan demand, management must adequately allocate resources to ensure a time shift in emphasis and in work flow. The examiner should analyze this area during the review of loans.

Serious lending policy and practice deficiencies will be noted in the Overview and a Record of Action which will correct the deficiencies noted will be developed with the board.

6. Compliance

The surety bond coverage and the insurance policies should be reviewed during every examination of a corporate.

6.1 Surety Bond

The examiner will determine that the corporate is meeting the minimum requirements for surety bond coverage as described in section 701.20 of the NCUA Rules and Regulations. If the corporate is meeting only the minimum requirements but is growing rapidly, the examiner should recommend to the board that additional coverage be obtained as an added safeguard.

6.2 Insurance

When reviewing the insurance policies in force, the examiner should pay special attention to any insurance purchased by the corporate from a league sponsored firm or a firm located in the building where the corporate's office is located. If the review discloses a problem with the insurance policy or with the insurance company used, it will be brought to the board of directors' attention at the joint conference. Exceptions will usually be listed on NCUA 2115, Examiner's Findings, but, if necessary, a Record of Action can be developed.

7. Conclusions/Total Analysis Process

The total analysis procedures established in chapter 16 of the Examiner's Guide will be applied to the corporate examination. Naturally, the examiner must consider the

unique nature and the commerical aspects of the corporate. These credit unions are generally larger and have access to high caliber management. Therefore, the standards applied and the expectations must be higher than those of natural person credit unions.

8. Assigning EWS Code

The criteria established for assigning the EWS Code for natural person credit unions (Supervision section of the Examiner's Guide) will be used in corporate credit unions with the following modifications:

a. Corporates not in compliance with Part 704 of the NCUA Rules and Regulations or those with serious problems as a result of noncompliance with the Act, with the bylaws, or with other Parts of the NCUA Rules and Regulations will be assigned EWS Code 3; and,

b. Corporates with serious financial and/or operational problems will be assigned EWS Code 4.

If EWS Code 4 is assigned, the examiner will retain a copy of the trial balance of the individual share and loan ledgers. This trial balance will be forwarded to the regional office with the examination report. The regional office will determine the potential impact on member credit unions in the event the corporate enters liquidation. The potential impact will be determined in two ways:

a. Review all share and share certificate accounts to determine the amount of uninsured funds for each credit union; and,

b. Determine which credit unions will be in an insolvent position as a result of the uninsured loss and if this position may force liquidation. The regional office will access NCUA's data system to obtain the most recent reserves, Undivided Earnings, and asset information to assist in determining the asset/share ratio.

9. Preliminary Meeting with Executive Management

Prior to the joint conference, the examiner will meet with executive management to review the examination findings, the major areas of concern, and the needed corrective action. In many cases, the depth of the discussion and the dialogue at this meeting will assist the examiner in obtaining specific agreements from the board of directors on the needed corrective action. Every effort must be made to assure this meeting is conducted on a professional and a productive level.

10. Joint Conference

The examiner will meet with the board for a joint conference (JC) at the conclusion of each examination. The joint conference should be scheduled so that the majority of the officials will be able to attend. The joint conference may need to be delayed after completion of the examination because the officials of the corporate

usually reside in locations distant from the credit union. This delay should normally not exceed 2-4 weeks after completion of the examination process and the meeting with executive management. Delays exceeding 4 weeks can be handled on a case-by-case basis by each regional director.

In addition, the regional director can authorize other means for providing the board of directors with the examination report; for example, conference telephone calls and so on.

The examiner will prepare a summary of the items to be discussed at the joint conference. This summary will be sent to all the officials in advance of the joint conference so that they will be informed of the credit union's problems and be better able to discuss them. This summary should include, as a minimum, the facts about the problem areas to be discussed, Examiner's Findings, Loan Exceptions, and financial schedules or reports. This procedure will be followed regardless of the method used to conduct the joint conference. Each region can determine the most appropriate method of report distribution in preplanning the joint conference.

11. Examination Report

It is important that the officials understand the problems that must be corrected. This is usually accomplished at the joint conference with the officials, but the examination report will be used to emphasize the problems that exist and to reinforce the corrective action necessary to address them.

In an effort to establish a more standardized report nationally, several workpapers will be standard in each examination. Since the number of required workpapers is minimal, each examiner has sufficient flexibility to add workpapers believed to be meaningful and useful to the officials. In addition to workpapers discussed elsewhere in this Examiner's Guide, each corporate examination report will contain the following workpapers:

a. Comparative Statement of Financial Condition;

b. Comparative Statement of Income and Expense;

c. Examination Financial Data;

d. Key Trends and Ratios;

e. Funds Management;

f. Closed Section;

g. Overview;

h. Record of Action (as applicable); and,

i. Cover Page for Examination and/or Insurance Review.

Each region will need to establish a supply of these forms in addition to the standard examination forms that will be used.

12. Regional Director Letter

When a corporate is assigned an EWS Code 2, 3, 4, or 5, the examiner will draft a letter for the regional director to send to the credit union. The letter is to contain specific references to problem areas and the agreements reached to resolve the areas of concern.

13. Return of Reviewed Workpapers

The review process and the return of the workpapers for a corporate examination may differ from that of a regular examination. Each regional office can establish its own system for release of the completed report to the credit union. A possible release method would be to have the open section of the report typed in the regional office on word processors and returned to the examiner for delivery. The report format could be stored in the word processors for continual use.

14. Supervision

If interim supervision is needed for a corporate, it will be in the form of a follow-up examination. In this manner, the board of directors is provided direct and documented information on the problems noted during the contact. The release of the final report will follow the procedures established in the previous section. This includes CLF Agent reviews.

14.1 EWS Code Updating

A corporate's EWS Code cannot be changed as a result of an on-site regular or follow-up examination unless specifically authorized by the regional director.

14.2 Financial Reports

Each regional office will secure monthly financial statements from each corporate, federally and privately insured, located within its region. Copies of these statements should be provided to the district examiner and, for federal credit unions, the statement data will be furnished to the Office of Programs in Washington. If significant and/or adverse trends are noted in the financial data, the region should take appropriate measures to follow up with the corporate.

15. Workpapers and references

a. Workpapers

(1) CCU1, Comparative Statement of Financial Condition
(2) CCU2, Comparative Statement of Income and Expense
(3) NCUA 2046, Financial Data
(4) CCU3, Key Trends and Ratios
(5) NCUA 2070, Funds Management
(6) NCUA 2238, Corporate Loan Profile
(7) NCUA 2141, Closed Section
(8) NCUA 2030, Overview
(9) NCUA 2035, Record of Action
(10) Cover Page for Federal Examination
(11) CCU4, Cover Page for Insurance Reviews
(12) NCUA 2390, Investment Internal Controls

b. References (other references in Examiners Guide)

(1) Federal Credit Union Act
Sections 120(a)

(2) NCUA Rules and Regulations

(a) 702 - Reserves

(b) 704 - Corporate Credit Unions

(3) Accounting Manual for Federal Credit Unions

Appendix A

This section contains both the required and the optional workpapers which are unique to the examination or to the insurance review of corporate credit unions. These workpapers are in addition to those NCUA standard workpapers required in the Examiner's Guide and discussed elsewhere in this chapter. The required workpapers are:

a. Comparative Statement of Financial Condition, CCU1. This will cover the last two full calendar years plus the current examination data. The percent columns will reflect the various assets/liabilities as a percent in relation to total assets and liabilities.

b. Comparative Statement of Income and Expense, CCU2. This will cover the same periods noted in the Comparative Statement of Financial Condition. The percentages requested will be stated as a percent of average assets.

c. Financial Data, NCUA 2045. This will be prepared during all examinations and will be included in the report to the officials.

d. Key Trends and Ratios, CCU3. This will provide data for the last 12 months and the last 3 months. The form is generally self-explanatory and the percentage will be calculated in the same manner as the NCUA 2046 ratios.

e. Funds Management, NCUA 2070. This will be prepared when a funds management report cannot be obtained from the corporate and will be included in the report to the officials.

f.) Corporate Loan Profile, NCUA 2238(6/80);

g. Closed Section, NCUA 2141;

h. Overview, NCUA 2030;

i. Record of Action, NCUA 2035;

j. Cover Page - Federal Examination;

k. Cover Page, CCU4 - Insurance Review; and,

l. Investment Internal Controls, NCUA 2390.

The regional office has several questionnaires which the corporate examiner may use as needed to perform an effective examination. These are, in some cases, older forms which may be of some benefit and their use is optional. The forms are:

a. Wire Transfer Questionnaire;

b. Corporate Review;

c. CLF Qualification Standards (would be required if examination was performed to determine qualification as a CLF Agent);

d. Corporate Loan Review; and,

e. Break-even Analysis.

STATE-CHARTERED INSURED CREDIT UNIONS

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STATE-CHARTERED INSURED CREDIT UNIONS

1. National Credit Union Share Insurance Fund (NCUSIF) Insurance of State Credit Unions

A large number of state-chartered credit unions (SCUs) are insured by the NCUSIF. The laws of some states require insurance with NCUSIF for their state credit unions. Some simply require share insurance and NCUSIF is one of several approved insurers. The laws of a few states do not require insurance, but the credit unions may be insured with NCUSIF at their option. NCUSIF provides exactly the same insurance coverage to state credit unions as to federal credit unions. However, the means of monitoring that insurance risk is quite different.

1.1 Application for Insurance of Accounts

Newly chartered or existing state credit unions may apply for NCUSIF insurance at any time as long as they comply with state law. Application is made by contacting the appropriate regional office, completing necessary application and agreement forms, and providing necessary background material. To aid in the application process, each regional office has a package of application materials. NCUA 9600, Application for Insurance of Accounts, State-Chartered Credit Unions, is supplied upon request to existing credit unions. NCUA 9600-1, Application for Insurance of Accounts, Newly Chartered State Credit Unions, is a modified package supplied to newly organized credit unions.

When processing insurance applications, NCUA staff considers the following:

a. The economic advisability of insuring the applicant without undue risk to the NCUSIF;

b. The history, financial condition, and management policies of the applicant;

c. The general character and fitness of the applicant's management;

d. The convenience and needs of the members to be served by the applicant; and,

e. Whether the applicant is a cooperative association organized for the purpose of promoting thrift among its members and of creating a source of credit for provident and productive purposes.

Title II of the Federal Credit Union Act and Part 741 of the National Credit Union Administration Rules and Regulations require NCUA to reject the application for insurance of any credit union if: (1) its reserves are inadequate, (2) its financial condition and policies are unsafe and unsound, (3) its management is unfit, (4) insurance

of its member accounts would otherwise involve undue risk to the NCUSIF, or (5) its powers and purposes are inconsistent with the promotion of thrift among its members and the creation of a source of credit for provident or productive purposes.

Along with the application of insurance, credit unions must sign an Agreement for Insurance of Accounts. A copy of the current Agreement is included at the end of this chapter. In consideration of share insurance, the Agreement basically requires the following of the insured state-chartered credit union:

a. Permit and pay the cost of examinations deemed necessary by the NCUA Board.

b. Provide NCUA access to all records including reports from other regulatory authorities.

c. Maintain minimum fidelity coverage as stated in NCUA Rules and Regulations Parts 701.20 and 741.

d. Meet, as a minimum, federal statutory reserve requirements as stated in Part 702 of the NCUA Rules and Regulations. Waivers of minimum reserve requirements and charges to the statutory reserve must have NCUA approval.

e. Maintain insurance deposits and pay insurance premiums pursuant to Title II of the Federal Credit Union Act.

f. Comply with the requirements of Title II (share insurance) of the Federal Credit Union Act.

g. Maintain an investment valuation reserve equal to the excess of book value over market value for all investments not authorized for federal credit unions.

h. Inform nonmember accounts other than deposits from other credit unions and public units that they are not insured.

NCUA's predominent concern relating to insured state-chartered credit unions is the risk to the Insurance Fund presented by the credit union. Only the requirements of Title II of the Federal Credit Union Act, Part 741 of the NCUA Rules and Regulations, applicable Interpretive Rulings and Policy Statements, and the Insurance Agreement are enforced by NCUA on insured state credit unions. Other regulations are enforced by the state regulatory agency. In regard to insured state credit unions, NCUA's primary concerns are safety and soundness issues. It should be noted that only the state regulator can place an insolvent state credit union into involuntary liquidation. However, the NCUSIF would absorb the losses of such a liquidation. When a credit union presents too high an insurance risk, NCUA can take administrative action to terminate insurance. This is explained in detail in the Administrative Actions chapter of the Guide.

1.2 Cooperation with State Regulatory Agencies

NCUA recognizes state regulatory agencies as the government agency primarily responsible for the supervision of insured state credit unions. NCUA maintains a sound cooperative working relationship with state regulators. State regulators assist NCUA in its effort to monitor insured credit unions by providing parts or all of the state examination reports or audits to the appropriate regional office.

When NCUA has a supervisory concern about a specific state credit union, it is shared with the state regulator. Officials of state credit unions are not contacted directly by NCUA staff concerning a supervisory matter without NCUA staff first consulting with the state regulator.

Management Information System (MIS) Reports listing the NCUA EWS Code assigned to state credit unions are available to state regulators. Each regional office develops its own means of communicating its concerns with the state regulator. This may be as informal as telephone calls or include monthly status reports. NCUA's concerns are usually limited to financial safety and soundness issues, which are shared with the state regulator. While views may differ, both NCUA and state regulators consider themselves as cooperative partners in the supervision of insured state credit unions.

1.3 Continued Insurability Status Report, NCUA 9653

As a convenience to NCUA, state regulators complete the Continued Insurability Status Report, NCUA 9653, as part of the examination report on insured state credit unions submitted to the regional office. In addition to key financial information, the report indicates compliance with regulatory requirements which insured state credit unions must satisfy. When the state examination report provides the information listed on the report, and the state regulator provides assurances that pertinent regulation compliance will be a routine part of the state examination process, the regional director may waive the need to complete this form.

1.4 Monitoring Insured Credit Unions

The primary means of monitoring the financial condition and the progress of insured state credit unions is through the review of examination reports completed by the state regulatory agency. In the majority of cases, this is the only analysis performed by NCUA staff on insured credit unions unless adverse trends are reported on the Financial Performance Report or other EDP analysis triggered by semiannual data. If no severe problems are indicated by this review, no further action is usually taken or required. On-site supervision is normally left to the state regulator.

Each region may develop its own EDP programs to analyze trends in state-chartered credit unions. These programs are usually produced semiannually, after collection and processing of the Call Reports, NCUA 5300. The specific reports, along with the Financial Performance Report (FPR), may be shared with the state regulator.

2. Early Warning System

The EWS System for state credit unions provides the same computerized inventory on the status of state credit unions insured by NCUSIF as it does for federal credit unions. The EWS lists by code those state credit unions with areas of possible weakness which need attention to maintain continued insurability standards. The system also provides a means to monitor the general condition of credit unions.

The EWS provides management with a tool to augment the supervision of insured state credit unions. This is accomplished in three stages:

a. Collection of data;

b. Analysis of data; and,

c. Storage of data.

This data comes primarily from the review of state examination reports by NCUA regional office staff. Additional information can be collected from CPA audits, financial and statistical reports, field contacts, communication with state regulators, and other sources.

NCUA staff evaluates the data in relation to risks to the NCUSIF and continued insurability standards. Risks are identified and assigned a condition code in the manner described in Section 3, Early Warning System, of the Surveillance System chapter of the Examiner's Guide. The problem areas and the overall EWS codes as described in the above-referenced chapter are exactly the same for both federal and state-chartered credit unions.

NCUA 2010, Examiner Contact Information, is the input document used to update NCUA's data base on the problem areas assigned. The overall EWS Code and the date of examination and completion are also recorded on this form. Instructions for completing the form are on its reverse. Data collected on NCUA 2010 is inputted directly by regional staff into the data base.

3. Examination Review of Insured State Credit Unions

The various state examination reports provide different types of information and are completed in a variety of formats. To allow the easiest analysis of examination information, it is helpful to convert the data to a standard format familiar to NCUA staff. This aids in the supervision of problem credit unions, allows NCUA management to more readily analyze data, and allows an easier interpretation and evaluation of state examination reports by persons familiar with the varying form of these reports.

To this end, some suggested key workpapers, which differ slightly from similar federal examination workpapers, are included at the end of this chapter. The decision to use these or other workpapers is up to each region. The data on these workpapers can be completed by technicians who are familiar with the composition of the various state

examination reports. This allows a speedy completion of forms and reduces the time necessary for analysts to review examinations and to assign proper problem areas.

3.1 Use of the State Examination Report

State regulators usually provide copies of their examination reports to the regional office on a flow basis. The state examination reports should be reviewed promptly, as this allows for more timely information. The submittal of an examination report initiates what is often the only annual in-depth review of an individual credit union by NCUA staff. When a state does not have an annual examination cycle, it is beneficial to analyze the state 5300s and the Financial Performance Reports to detect adverse trends. Requests for extra supervision of known problems by the state regulator are also helpful.

The primary emphasis in reviewing state examination reports is problem identification. When severe problems are noted, it is important to assure that appropriate supervision is provided. States will use a variety of means to bring about corrective action. Some states will make additional supervision contacts on problem credit unions. Usually, special follow-up will be initiated by NCUA on credit unions classified as Codes 4 and 5 and the largest of Code 3s. This is to limit the demands and the requests placed on the state regulator as well as on NCUA staff time.

3.2 Financial Data, NCUA 2045S

To allow a rapid comparison of quantitative data, this suggested form is completed by staff as of the effective examination date. The form is similar to NCUA 2045, Financial Data, used in the examination of federal credit unions. Some data has been changed or eliminated as it is not readily available. Certain states may not provide all the information, in which case it must be omitted. Definitions and instructions for completing the form are on its reverse.

This is a continuous form. Data for the current examination will be entered on the first available left-hand column. Only data for the effective date of the examination is entered. This allows data from up to four examinations to be compared on one form.

Various states have different criteria for classifying problem loans. The form allows for capturing both the states' classifications and the classifications based on a formula of 50 percent of delinquent loans in the 6- to 12-month category and 75 percent of loans delinquent in excess of 12 months. Each region can decide which classification to use for various states. A conservative policy would be to use the largest classification for purposes of ratio calculation.

3.3 Key Ratios, NCUA 2046S

The same ratios are computed by staff on suggested NCUA 2046S, Key Ratios, as on the federal examination form. The narrative explanation of the ratio is omitted and replaced with a mathematical formula to assist staff in the calculation. This is a

continuation form. Information as of the effective date of the examination will be completed on the first available column to the left. A column for the FPR peer group ratio also is available for those ratios calculated by the FPR. This provides analysts with a means of comparing ratios to the norm for the peer group.

3.4 Asset Share Ratios, NCUA 2047S

The suggested Probable Asset Share Ratio (PAS) form may be completed for each state examination report reviewed. This is also a continuation form, allowing completion for four examination periods. The credit union's total assets (as presented on the examination balance sheet) is used as the starting point, with appropriate deductions made as indicated by the examination report. For those states which do not use a valuation allowance for loans, the allowance is assumed to be zero. Specific instructions for completing the form are on its reverse.

The PAS reflects a credit union's financial condition based on an on-going concern concept. Assets are assigned at their most realistic value over the life of the asset. Probable losses are deducted from the value of assets. Also, recorded and unrecorded or contingent liabilities are treated as deductions to arrive at the net value of assets. The PAS is computed by dividing the net value of assets by the total of all classes of shares. The resulting ratio reflects the relative worth of $1 of shares in the credit union using an on-going concept.

Technicians and analysts should note that deficits in Net Income or Undivided Earnings are not treated as further reductions to net asset value if these items are properly recorded on the credit union's records. The proper recording of these items has already reduced the book value of assets accordingly.

The PAS is a key ratio in analyzing the credit union's solvency and is a basis for recommended EWS rating in the Surveillance System chapter of this Guide. The ratio should equal 100 for a solvent credit union and have a stable or increasing trend over time.

3.5 Financial Performance Report (FPR)

A valuable tool to assist in monitoring the financial condition of insured state credit unions is the FPR. The FPR's overall percentile can be used to indicate problem credit unions. Insured credit unions with very low percentiles should be reviewed to assure that all problems are known and that appropriate action is being taken by NCUA or by a state regulator. This is especially important for those credit unions assigned an EWS Code of 1 or 2. In this way, the FPR can be used as a safety check on the state examination review process to assure that all problems are identified.

The FPR is also used in the completion of NCUA 2046S. The most recent peer group ratio for those ratios calculated by the FPR is listed for comparison purposes. This, along with the print-out of those ratios in which the credit union ranks in the low 25 percentile, can assist in quickly identifying areas of weak performance.

Perhaps the most value the FPR provides to the analytical process is that the report provides a 5-year historical trend analysis. This review is also provided in a consistent format that assists in understanding the developments in a particular credit union. Many states provide this data, but in a format not familiar to the analyst or to NCUA management.

3.6 Problem Area/EWS Code Assignment

An end-product of the review of the state examination report is the assignment of the appropriate problem areas and the EWS Code. The data is recorded on NCUA 2010, Examiner Contact Information. The codes are exactly the same as for federal credit unions described in the EWS section of the Surveillance chapter.

4. Problem Insured State Credit Unions

The most important task related to the review of state examination reports is the identification and the monitoring of credit unions with severe problems. These credit unions are usually those assigned EWS Codes 4 or 5. However, because of their size and their potential impact on the NCUSIF, large Code 3 credit unions also may require special monitoring.

The method of communicating NCUA's concerns to the state regulator and the credit union is best developed by each region and may vary from state to state. The state regulator should be informed of NCUA's assigned EWS Code. The state regulator is normally depended upon to do the bulk of the direct supervision of the credit union. However, with problem and large credit unions, it may be necessary to make specific supervision requests and recommendations to the state regulator. It may also become necessary for NCUA staff to make an on-site contact at the credit union. Direct or on-site contacts with insured state credit unions are made only after contacting and/or coordinating the contact with the state regulator.

4.1 Periodic Monitoring of Problem Credit Unions

The specific means of monitoring problem credit unions is left for each region to determine. Some state regulators make necessary follow-up and supervision contacts. Requests for reports of these contacts may be appropriate. If the state examination report does not adequately address a severe problem, it may be necessary for regional office staff to initiate follow-up.

Regardless of the method used, NCUA staff cannot allow a credit union with severe financial and operational problems which present a high degree of risk to the NCUSIF to go without appropriate supervision.

5. On-site Insurance Reviews

When an insured state credit union presents a high degree of risk to the NCUSIF or requests 208 assistance, or when the Agency is uncertain of the true financial condition and/or correction efforts of the officials, an on-site insurance review may be performed by NCUA staff. The contact is coordinated with the state regulator and the state regulatory staff will likely participate in the contact.

There is no prescribed format for an on-site contact. It may be a short fact-finding visit; in which case, the contact will be of very limited scope. In such cases, a memorandum reporting the results of the contact will usually be sufficient.

Most insurance reviews, however, will resemble the format of a federal examination, with emphasis and expansion in those areas causing the most concern. When this type of contact is made, a report of the contact will be compiled. This summarizes the results of the contact and allows for a point of reference should further supervision or administrative action become necessary. As a minimum, a report of an on-site insurance review should include at least the following:

NCUA 2010 Examiner Contact Information
NCUA 2030 Examination Overview
NCUA 2035 Record of Action
NCUA 2045 Examination Financial Data
NCUA 2046 Key Ratios
NCUA 2050 Statement of Financial Condition (or equivalent)
NCUA 2051 Statement of Income (or equivalent)
NCUA 2110 Classified Loans (or equivalent)
NCUA 2141 Closed Section
Appropriate workpapers on areas of concern

The amount of guidance provided to officials will depend on the working relationship with the state regulator. A joint conference with officials is not mandatory on insurance reviews. However, when serious problems are noted, a joint meeting including state regulators should be scheduled. Normally, the findings of the on-site contact will be reviewed and discussed with the regional director and/or the regional office staff prior to a meeting with officials and to the formal report being released to the state regulator. The actual release of the report to the officials and discussions with the officials are matters of regional policy and can be decided on a case-by-case basis.

6. Workpapers and References

a. 2010 Examiner Contact Information.

b. 2045S Examination Financial Data (State).

c. 2046S Key Ratios (State).

d. 2047S Share Asset Ratios (State).

e. 9600 Application for Insurance of Accounts, State-Chartered Credit Unions.

f. 9600-1 Application for Insurance of Accounts, Newly Chartered State Credit Unions.

g. 9653 Continued Insurability Status Report.

h. Agreement for Insurance Accounts.

i. Financial Performance Report.

AGREEMENT FOR INSURANCE OF ACCOUNTS

Date _____

The _____ Credit Union,
Insurance Certificate Number _____

_____ _____
(mailing address) (city, state, zip code)

agrees to the following in consideration of the continuation of federal insurance:

1. To permit and pay the cost of such examinations as the NCUA Board deems necessary for the protection of the interests of the National Credit Union Share Insurance Fund;

2. To permit the Board to have access to all records and information concerning the affairs of the credit union, including any information or report related to an examination made by or for any other regulating authority, and to furnish such records, information, and reports upon the request of the NCUA Board;

3. To possess such fidelity coverage and such coverage against burglary, robbery, and other losses as is required by Parts 701.20 and 741 of NCUA's regulations;

4. To meet, at a minimum, the statutory reserve and full and fair disclosure requirements imposed on Federal credit unions by Section 116 of the Federal Credit Union Act and Part 702 of NCUA's regulations, and to maintain such special reserves as the NCUA Board may by regulation or on a case-by-case basis determine are necessary to protect the interests of members. Any waivers of the statutory reserve or full and fair disclosure requirements or any direct charges to the statutory reserve other than loss loans must have the prior written approval of the NCUA Board. In addition, corporate credit unions shall be subject to reserve requirements specified in Part 704 of NCUA's regulations;

5. Not to issue or have outstanding any account or security the form of which has not been approved by the NCUA Board, except accounts authorized by state law for state credit unions;

6. To maintain the deposit and pay the insurance premium charges imposed as a condition of insurance pursuant to Title II (Share Insurance) of the Federal Credit Union Act;

7. To comply with the requirements of Title II (Share Insurance) of the Federal Credit Union Act and of regulations prescribed by the NCUA Board pursuant thereto; and

8. For any investments other than loans to members and obligations or securities expressly authorized in Title I of the Federal Credit Union Act, as amended, to establish now and maintain at the end of each acounting period and prior to payment of any dividend, an Investment Valuation Reserve Account in an amount at least equal to the net excess of book value over current market value of the investments. If the market value cannot be determined, an amount equal to the full book value will be established. When at the end of any dividend period, the amount in the Investment Valuation Reserve exceeds the difference between book value and market value, the board of directors may authorize the transfer of the excess to Undivided Earnings.

READEX FICHE

9. When a state-chartered credit union is permitted by state law to accept nonmember shares or deposits from sources other than other credit unions and public units, such nonmember accounts shall be identified as nonmember shares or deposits on any statement or report required by the NCUA Board for insurance purposes. Immediately after a state-chartered credit union receives notice from NCUA that its member accounts are federally-insured, the credit union will advise any present nonmember share and deposit holders by letter that their accounts are not insured by the National Credit Union Share Insurance Fund. Also, future nonmember share and deposit fund holders will be so advised by letter as they open accounts.

10. In the event a state-chartered credit union chooses to terminate its status as a federally-insured credit union, then it shall meet the requirements imposed by Sections 206(a)(1) and 206(c) of the Federal Credit Union Act and Part 741.6 of NCUA's regulations.

11. In the event a state-chartered credit union chooses to convert from federal insurance to some other insurance from a corporation authorized and duly licensed to insure member accounts, then it shall meet the requirements imposed by Sections 206(a)(2), 206(c), 206(d)(2), and 206(d)(3) of the Federal Credit Union Act.

CERTIFICATION

We, the undersigned, certify that we are the duly elected and qualified presiding officer and secretary of the credit union and that at a properly called regular or special meeting of its board of directors, at which a quorum was present, the following resolution was passed and recorded in its minutes:

> "Be it resolved that the president and treasurer be authorized and directed to execute the Agreement for Insurance of Accounts as prescribed by the NCUA Board and to pay all expenses and do all such other things necessary or proper to continue in force such insurance."

We, the undersigned, further certify that to the best of our knowledge and belief no officer, committee member, or employee of this credit union has been convicted of any criminal offense involving dishonesty or breach of trust, except as noted in attachments. We further agree to notify the Board if any existing officer or future officer commits a criminal offense.

_____
(Signature)
Presiding Officer, Board of Directors

_____
(Signature)
Secretary, Board of Directors

_____
(Print or Type Presiding Officer's Name)

_____
(Print or Type Secretary's Name)

FINANCIAL DATA

2045S

Certificate _____

Name _____

Contact Date					
1.	Total Loans				
2.	Total Investments				
3.	Investments Market Value				
4.	Non-Earning Assets				
5.	Total Assets				
6.	Average Assets				
7.	Share Deposits Less Than 1 Year				
8.	Share Deposits Greater Than 1 Year				
9.	Total of All Shares				
10.	Statutory Reserves				
11.	Other Reserves				
12.	Undivided Earnings				
13.	Total Retained Earnings				
14.	Gross Income YTD				
15.	Operating Expenses				
16.	Cost of Funds (1)				
17.	Non-Operating Gain or (Loss)				
18.	Profit After Dividends				
19.	Reserve Transfer Projected				
20.	Net Income (Loss) From Operations YTD.				
21.	Delinquent Loans in Excess of 2 Mon.				
22.	Collection Problem Loans per State				
23.	Collection Problem Loans per 50/75 Formula				
24.	Other Losses				
25.	_____				

Footnotes

(1) The cost of funds YTD is estimated by formula.
(2)
(3)

TRIGGERS

		Yes	Yes	Yes	Yes
1.	Material Increase/Decrease to Tl. Asst.				
2.	Material Change in Loan Structure				
3.	Material Change in Investment Structure or Maturity				
4.	Material Change in Share Structure				
5.	Material Decline in Total Ret. Earnings				
6.	Increase in Total Delinquent Loans and/or Delinquent Loan Ratio				
7.	Increase in Classified Loans to Total Retained Earnings Ratio				
8.	Negative Profit Ratio and/or Decreasing Profit Ratio				
9.	Neg.Trend in Probable Asset Share Ratio				
10.	Erratic Trends or Ratios				

INSTRUCTIONS

Enter data for the current examination date in the left hand column. The periods used will be clearly labeled.

Usually the data collected for the current examination will be identical to the information contained on the financial reports submitted with the State Examination Report. Analysts will use projected or pro-forma data when the analyst determines these amounts more accurately reflect the credit union's condition. Projected or pro-forma amounts will be clearly footnoted. Workpapers detailing the computation of projected or pro-forma amounts will be included with workpaper.

When completing the income and expense items (lines 14 through 20) for this current examination period, year to date information will be collected. If the credit union does not accrue the cost of funds or the cost of funds reported is not current the cost of funds will be estimated. Estimates will be made by using the latest FPR cost of funds to average assets for the credit union times line 5 and adjusting for the number of months year to date.

1. **TOTAL LOANS** - All loans to members.

2. **TOTAL INVESTMENTS** - All investments at book value.

3. **INVESTMENT MARKET VALUE** - Market value as of the current date as determined by state. Do not attempt to determine previous market values if not readily available.

4. **NON-EARNING ASSETS** - The sum of all assets which do not generate revenue. Usually all assets except loans and investments.

5. **TOTAL ASSETS** - Book value of all assets.

6. **AVERAGE ASSETS** - Last Exam plus this exam divided by 2.

7. **SHARE DEPOSITS LESS THAN 1 YEAR** - All share deposits with remaining maturities less than 1 year. If not readily available, put N.A.

8. **SHARE DEPOSITS GREATER THAN 1 YEAR** - All share deposits with remaining maturities greater than 1 year. If not readily available put N.A.

9. **TOTAL SHARES** - Sum of all share accounts.

10. **STATUTORY RESERVES** - Regular Reserves and Special Reserves required by State or NCUA.

11. **OTHER RESERVES** - Sum of all reserve accounts excluding statutory reserves and and Undivided Earnings.

12. **UNDIVIDED EARNINGS** - Undivided Earnings Balance.

13. **TOTAL RETAINED EARNINGS** - Sum of lines 10, 11, and 12.

14. **GROSS INCOME** - Total gross income YTD. Footnote exceptions to this procedure.

15. **OPERATING EXPENSES** -Operating expenses YTD covered. Excludes Interest on Borrowed Money, deposit accounts and and dividends.

16. **COST OF FUNDS** - Cost of funds for YTD. Includes cost of borrowed money, deposit account interest and dividends.

17. **NON-OPERATING GAIN (LOSS)** - As reported by State for YTD.

18. **NET INCOME (LOSS) AFTER DIVIDENDS** - Line 14 less lines 15, 16, and 17.

19. **RESERVE TRANSFER** - Project required reserve transfers for the YTD, by determining transfer position 5% or 10%. The result may not be less than zero.

20. **NET INCOME (LOSS) FROM OPERATIONS** - Line 18 less line 19.

21. **DELINQUENT LOANS IN EXCESS OF 2 MONTHS** - The total of all loans delinquent more than 2 months.

22. **COLLECTION PROBLEM LOANS PER STATE**

23. **COLLECTION PROBLEM LOANS PER 50/75 FORMULA** - The sum of 50% of loans delinquent 6-12 months and 75% of loans delinquent more than 12 months.

24. **OTHER LOSSES** - Known or estimated losses other than loan and investment losses, deficit balance in Undivided Earnings or net loss for current accounting period. As reported per State.

25. **COMPLETE AS NEEDED.**

KEY RATIOS

Certificate _____
Name _____

PERIODS	YTD	Peer Group FPR	YTD	Peer Group FPR	YTD	Peer Group FPR	YTD	Peer Group FPR
1. MARKET GROWTH Line 9 less line 9 prior divided by line 9 prior Divided by mos since prior X 12	____	***	____	***	____	***	____	***
2. LOANS TO ASSETS Line 1 divided by line 5	____	____	____	____	____	____	____	____
3. NON EARNINGS ASSETS TO ASSETS Line 4 divided by line 5	____	***	____	***	____	***	____	***
4. RESERVE CHANGE Line 13 current less line 13 prior divided by line 13 prior. Divided by mos since prior X 12	____	***	____	***	____	***	____	***
5. CAPITAL Sum of line 9 and 13 divided by line 9	____	____	____	____	____	____	____	____
6. DELINQUENT LOAN Line 21 divided by line 1	____	____	____	____	____	____	____	____
7. CLASSIFIED LOANS TO RETAINED EARNINGS Larger of line 22 or 23 divided by line 13	____	***	____	***	____	***	____	***
8. PROBABLE ASSET SHARE See NCUA 2047	____	***	____	***	____	***	____	***
9. YIELD ON ASSETS Line 14 divided by line 6 Divided by mos YTD X 12	____	____	____	____	____	____	____	____
10. OPERATING EXPENSES TO ASSETS Line 15 divided by line 6 Divided by mos YTD X 12	____	____	____	____	____	____	____	____
11. COST OF FUNDS TO ASSETS Line 16 divided by line 6 Divided by mos YTD X 12	____	____	____	____	____	____	____	____
12. NET INCOME (LOSS) AFTER DIVIDENDS TO ASSETS Line 18 divided by 16 Divided by mos YTD X 12	____	____	____	____	____	____	____	____
13. NET INCOME FROM OPERATIONS TO ASSETS Line 20 divided by 16 Divided by mos YTD X 12	____	***	____	***	____	***	____	***

Line items from Financial Data Form
FPR Location see Examiner's Guide Examination Section 16.3
*** FPR not available

INSTRUCTIONS

The ratios will normally be completed for the same periods for which data was collected on NCUA 2048, Examination Financial Data. However, when interim period data has not been collected on NCUA 2048 the ratios available from the credit union's most recent Financial Performance Report (FPR) will also be included. The ratio columns will be clearly dated and arranged in chronological order from oldest to most recent.

The most recent FPR peer group average will also be listed for those ratios calculated by the FPR. The credit union's peer group average can be obtained from the most recent FPR for the credit union.

Ratios 1, 4, 9, 10, 11, 12 and 13 must be annualized to provide a meaningful basis for comparison. Data can be annualized by multiplying by 4 if the data is for a quarterly period, or by multiplying by 2 if data is semiannual. If the data is for other than a quarter or semiannual period, divide by the number of months in the period and multiply by 12.

NCUA 2048 collects most of the data necessary to compute the Key Ratios. The market growth and capital ratios for the previous date will be computed by using shares and total retained earnings for a period 12 months prior to that date. This data can be obtained from the credit union's financial reports.

The following are formulas for computing the Key Ratios with NCUA 2048 line items:

Market Growth: Line 12 less line 12 prior period, divided by line 12 prior period. Annualized as necessary.

Loans to Assets: Line 1 divided by line 6.

Non-earning Assets to Assets: Line 5 divided by line 6.

Reserve Change: Line 16 current period less Line 16 prior period divided by Line 16 prior period. Annualized as necessary.

Capital: The sum of line 12 and line 16 divided by line 12.

Delinquent Loan: Line 24 divided by line 1.

Classified Loans to Retained Earnings: Line 25 divided by line 16.

Probable Asset Share: Instructions on NCUA 2047, Asset Share Ratios.

Yield on Assets: Line 17 divided by line 7. Annualized as necessary.

Operating Expenses to Assets: Line 18 less line 27, divided by line 7. Annualized as necessary.

Cost of Funds to Assets: Line 19 divided by line 7. Annualized as necessary.

Net Income (Loss) After Dividends to Assets: Line 21 divided by line 7. Annualized as necessary.

Net Income (Loss) From Operations to Assets: Line 23 divided by line 7. Annualized as necessary.

NCUA 2047 S

NAME _____
CERT# _____
STATE _____

PROBABLE ASSET SHARE RATIO

EXAMINATION DATE		_____		_____
Credit union assets per balance sheet	_____	_____	_____	_____
Deductions				
Recorded Liabilities.....	_____		_____	
Classified loans in excess of Allowance.....	_____		_____	
Estimated reduction in other assets.....	_____		_____	
Unrecorded liabilities...	_____		_____	
Projected cost of funds in excess of recorded cost of funds.....	_____		_____	
Total deductions.....		_____	_____	_____
NET APPRAISED VALUE OF ASSETS:.....		_____	_____	_____
TOTAL SHARES AND DEPOSITS.....		_____	_____	_____
PROBABLE ASSET SHARE RATIO (PAS).....		_____	_____	_____

INSTRUCTIONS
Probable Asset Share Ratio

The Probable Asset Share Ratio reflects a credit union's financial condition based on an on-going concern concept. Only differences between market value of an asset and book value which are likely to materialize are considered.

Credit Union assets per balance sheet: Assets as shown by the examination report. This includes reductions in assets due to allowances for depreciation and asset valuation reserve accounts.

Deductions:

Recorded liabilities: All recorded liabilities as shown by the examination balance sheet.

Classified loans in excess of allowance: If the State examination report does not include an allowance for loan losses account, the account is assumed to have a zero balance and all classified loans are deducted. If classified loans (as shown by the State or by 50/75 formula) exceed the allowance, the amount of the excess is deducted. If the allowance account is more than classified loans, the difference is ignored unless material, in which case the amount of the difference would be shown as a negative figure.

Estimated reduction in other assets: Other asset reductions only if they are expected to materialize.

Unrecorded liabilities: All known or contingent liabilities which are not recorded.

Projected cost of funds in excess of recorded cost of funds: Any excess of projected cost of funds as indicated by the State or NCUA personnel over recorded dividends. This is critical to complete when the credit union does not accrue dividends payable.

Total deductions: The sum of all the above deductions.

Net Appraised Value of Assets: The remainder after subtracting total deductions from assets per balance sheet.

Total shares and deposits: Includes drafts, certificates, IRAs, club accounts, non-member shares, money market shares, and deposits. The same as line 9 on NCUA 2045 S Financial Data.

The PAS is computed by dividing the net value of assets by all shares. The resulting ratio reflects the relative worth of $1.00 of shares using an on-going concern concept.

ADMINISTRATIVE ACTIONS

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ADMINISTRATIVE ACTIONS

1. In General

1.1 Nature and Purpose

Administrative actions are procedures available to the Agency designed to to prevent, to alter, or to eliminate operational problems in a credit union or, if correction of the problem is not feasible, to liquidate the credit union. Although credit union officials may view these actions as punitive in nature, and there may be punitive aspects to certain types of actions, their true purpose is to provide protection to the credit union, its members, its creditors, and the NCUSIF. Administrative actions are reserved for those credit unions that have serious operational and/or management problems that have not been or cannot be, resolved through normal supervisory efforts. They are not to be used as a convenient short cut of NCUA's supervisory responsibilities.

Administrative actions represent the strongest supervisory tools available to NCUA. The actions generally used to correct problems and to ensure the continued existence of credit unions include:

a. Cease and Desist;

b. Civil Money Penalties;

c. Removal of Directors and Officials;

d. Prohibition Against Officials and Other Persons; and,

e. Conservatorship.

The more drastic forms of actions include:

a. Termination of Share Insurance (generally limited to federally insured state-chartered credit unions);

b. Liquidation (insolvent federal credit unions);

c. Revocation of Charter (solvent federal credit unions); and,

d. Conservatorship.

Conservatorship is included in both categories since it can be utilized to correct problems or as a preliminary step to liquidation depending on the condition of the credit union.

Generally, when an administrative action is initiated by NCUA, an Administrative Law Judge (ALJ) is appointed to hear both sides of the case. The ALJ then submits a recommended decision to the NCUA Board. The Board then issues a final order that either adopts, modifies, or rejects the findings of the ALJ. The party subject to the order may appeal the final order through the federal court system. Certain administrative actions may be directly challenged in court without involvement of an ALJ; for example, temporary cease and desist or removal orders and conservatorship actions.

1.2 Scope

This portion of the guide primarily addresses the examiner's involvement in those remedial tools that, unless consented to by the credit union, are adversarial in nature and normally involve a determination of facts and a conclusion of law by an independent third party. These types of actions are listed under paragraph 1.1 Nature and Purpose, above. A brief discussion has also been included on a nonadversarial-type order to establish a Special Reserve for Losses even though this type of action is generally supervisory in nature.

Not discussed here are the penalties imposed for failure to take or to perform certain actions or duties. For your information, however, those penalties are: (a) $100 fine for each day a credit union willfully fails to file a report of condition required by the NCUA Board (Section 202(a)(3), 12 U.S.C. Section 1782(a)(3)); (b) $100 fine for each day a credit union willfully fails to file any certified statement or to pay its deposit or premium charge (Section 202(c)(2)); and (c) $1,000 fine and/or 1-year imprisonment for any official who knowingly participates in the distribution of dividends or assets while the credit union is in default on its payment of its deposit or insurance premium (Section 202(c)(3)).

In the paragraphs that follow, the NCUA Rules and Regulations will be referred to as 12 C.F.R., followed by the appropriate part or section number. References to the Federal Credit Union Act will be stated as, for example, "Section 206(h)," and will usually be followed by its official citation, 12 U.S.C. 1786(h).

1.3 Examiner's Role

The examiner has a key role in administrative actions. The examiner is on the scene and must be aware when conditions at a credit union are such that an administrative action is necessary. The examiner is the party primarily responsible for developing the facts that form the core of an administrative record and he or she generally will be the principal witness in any subsequent administrative or judicial hearing. The administrative record is the total collection of information that forms the basis for the Agency's decision on a given matter. It is the administrative record that is the subject of judicial review when the Agency's decision is challenged.

When the examiner encounters a credit union with a persistent problem and previous examination and supervision reports contain sufficient information to show that the present officials have had ample time to resolve the problem, a determination of why

the problem has not been corrected will need to be made. In addition to objectively evaluating the previous actions of management in dealing with the problem, the examiner will also need to assess efforts expended in attempting to assist the officials in eliminating the problem. After the examiner has determined why the problem has persisted, the cause of the problem can be identified. If the cause of the problem is traceable to ineffective management, the examiner's theme should be "if current officials cannot manage the credit union in a satisfactory manner, they should give way to those who can." Such an approach must be tempered in relation to available replacements and the significance of the problem. If the plans for action are realistic and workable but do not result in corrective action or improved condition, the examiner will need to resort to more direct measures. Reorganization of the officials may be the only solution where the persistent problem is caused by unqualified or inactive management. A Cease and Desist Order will be, in most cases, the most appropriate type of administrative action in dealing with the persistent, serious problem syndrome. It will cause the officials to take positive, constructive action to correct or to eliminate the deficiencies causing the problem or to resign so that others will be able to serve. However, it should be noted that a Cease and Desist Order may not be appropriate to the case if the persistent problem is serious and increased risks to the NCUSIF will result because of the delays inherent in this type of action.

Generally, a persistent, serious problem may be viewed as any major area of concern that:

a. Is an unsafe or unsound practice that is having, or could have, a reasonably direct effect on the financial soundness of a credit union; or,

b. Is a serious violation of a law, rule, regulation, condition or agreement imposed by the NCUA Board; and,

c. Has been reported on adequately in at least one previous examination or follow-up examination report or, in the case of a federally insured state-chartered credit union, in correspondence released by the state supervisory authority and/or the NCUA; and,

d. Is a practice or condition that can be resolved by one or more officials who presently are unresponsive or are unwilling to take the necessary steps to effect correction.

Since it is not a hard and fast rule that a persistent problem exists only when the above conditions are present, an examiner must exercise sound judgment when evaluating problems that may warrant an administrative action.

In federally insured state-chartered credit unions, the examiner usually will be informed by the regional director of apparent serious operational and/or management deficiencies that appear to be causing unsafe and unsound practices or conditions that threaten continued insurability of the credit union by the NCUSIF. An examiner in these cases normally will be assigned the task of investigating the allegations and of reporting the findings to the regional director. The regional director will communicate plans for these contacts with the state regulatory agency and arrange for any state examiner participation.

In all cases, the examiner should consult with the supervisory examiner before submitting a recommendation for administrative action. The supervisory examiner's concurrence with the recommendation should be noted in a memorandum to the regional office.

All facts and circumstances surrounding the particular violation of the charter, the Act, the bylaws, the NCUA Rules and Regulations, a condition. an agreement, or safe and sound practices must be examined thoroughly to determine the appropriate action. Some of the relevant considerations are:

a. Financial condition of the credit union;

b. Interests of the membership;

c. Impact on the NCUSIF;

d. Interest exhibited by management in the continued existence of the credit union;

e. Ability of mangement to effectively carry on the operations;

f. Sponsor's economic condition;

g. Overall prevailing economic conditions in the area; and ,

h. Creditors' interests.

1.4 Examiner's Recommendation

Each examiner must know the types of administrative actions that are available, the grounds for issuance, and their objectives. Administrative actions are a serious matter and a costly process for NCUA and for the credit union. An administrative action should be recommended by the examiner only after all supervisory efforts to effect change have been initiated and these efforts have not brought about satisfactory results or if the situation is such that supervisory efforts would prove futile. In recommending an adminstrative action, it is the least drastic form of action that will accomplish the desired result that is the most appropriate.

Recommendations for administrative actions not delegated to the regional director for issuance will be transmitted to the Washington Office by the regional director. Actions issued and recommendations made by the regional director will be based on the information provided by the examiner. The examiner may make a recommendation at the conclusion of an examination or of a supervision contact. A memorandum will be prepared by the examiner to supplement the examination or supervision report and must include:

a. Type of action recommended (least severe action that will obtain the desired objective);

b. History of operations since problems first appeared and supervision efforts made, agreements reached, and corrective action taken by officials;

c. Pertinent trends supporting charges and recommendations;

d. Probable asset share ratio computation;

e. If insolvent, a discussion of the "escape clause" cited in the NCUA Rules and Regulations, 12 C.F.R. Section 700(k)(1);

f. Root causes of the problems;

g. The grounds for the type of acton recommended, i.e., the specific violations of the charter, the Act, the bylaws, the NCUA Rules and Regulations, a condition, an agreement or the unsafe or unsound practice or condition, breach of duty, or loss, and the facts to support each charge;

h. Where appropriate, a discussion of alternatives to the action, such as merger, special assistance, voluntary liquidation; and,

i. Rationale for the action recommended. This should include a discussion of why less drastic forms of action from that recommended would not be appropriate. For example, if a federal credit union is solvent and the examiner recommends revocation of charter, the memorandum should include a statement as to why a cease and desist action or conservatorship would not be appropriate.

The regional office will review the examiner's recommendation to determine if there are sufficient grounds for an administrative action and to determine whether the specific type of action recommended by the examiner is the most appropriate. Anytime the examiner learns of new information of material significance, particularly if subsequent to the the initial recommendation but before delivery of the administrative notice or order, the facts should be promptly communicated to the supervisory examiner and the regional director.

1.5 Delivery

The examiner usually will be assigned to deliver the notice (or order) to the credit union and to obtain a signed receipt (typed on copies of the notice) from the person who accepts delivery. The examiner will give the highest priority to the delivery of the enforcement action consistent with guidance provided by the regional director.

In unusual cases when the notice or order is mailed directly to the credit union, the examiner will receive a copy from the regional office.

The examiner will generally receive delivery instructions through the supervisory examiner from the regional director. Refusal by the credit union officials to accept the notice or order will not alter its force or effect. If such a situation arises, the examiner should place the original of the administrative action in a conspicuous place designated

as the credit union's place of business in view of at least one official. Such an unorthodox delivery, or inability to effect delivery, should be reported promptly to the supervisory examiner and noted on a copy of the notice or order. If the administrative action includes an appointment of an agent and the officials refuse to release the records, this fact also should be promptly reported to the supervisory examiner.

The examiner should be familiar with the rules and procedures applicable to administrative actions that allow responses and may lead to hearings as provided in Part 747 of the NCUA Rules and Regulations. The credit union will be given general guidance as to its options and the time frame for responses in the notice or order. Under no circumstances should the examiner become involved in a discussion with the officials on matters that require legal interpretation of rights and alternatives. Instead, the officials should be advised to refer to Part 747 of the NCUA Rules and Regulations.

1.6 Contacts After Delivery

The supervisory examiner, with instructions from the regional director, will give specific guidance to the examiner regarding the supervision of the credit union after an administrative action has been delivered. In all cases, the supervision plan assigned will be directly related to the type of administrative action served on the credit union or the person and the time frame for the credit union or the person to exercise the right to due process as established in the NCUA Rules and Regulations.

Additional facts relating to the charges cited in the enforcement action will often need to be developed for NCUA's use in a hearing or in a final decision on the action being sought. High priority should be given to these assignments. The examiner should refrain from making statements during the supervision contacts which could prejudice the case or place NCUA in an untenable or an unsupportable position.

1.7 Challenges in U.S. District Court

The examiner must be aware that in the case of a Temporary Cease and Desist Order, Immediate Suspension or Prohibition of an official or other person, or Conservatorship, the Act provides that the Agency's action may be challenged in U.S. District Court within 10 days of service of the order. A credit union may also challenge even though there is no provision for such action in the Act. Such challenges can be initiated almost immediately after service of the order and the Agency has little time to respond. Representation of the Agency in court proceedings is done through the Office of Legal Services and the Department of Justice or the various U.S. Attorneys' Offices and time is needed to process pleadings through these offices. Therefore, if an examiner believes that an administrative action will be challenged, the supervisory examiner or the regional office must be notified immediately.

2. CEASE AND DESIST (12 U.S.C. Section 206(e) and (f); 12 C.F.R. Subpart C Section 747.301)

2.1 Nature and Purpose

Pursuant to Section 206(e) of the Act, the NCUA Board is empowered to issue a notice of charges and to arrange for an administrative hearing to determine whether an order should be issued to a credit union or to specified persons ordering it or them to either stop certain activity or to take affirmative action to correct particular problems. Because there is a minimum of 30 days between the time a notice is served and the hearing is held, Section 206(f) authorizes the Board to issue a temporary cease and desist order which takes effect immediately upon delivery. (See paragraph 2.5 below.) Such a temporary order is used when conditions are so serious that immediate action is necessary. It is usually issued at the same time a notice of charges and hearing is issued and remains in effect until such time as the Board either withdraws it or issues a permanent order after a hearing.

A Cease and Desist Order, whether permanent or temporary, is, in effect, an injunction. It is the NCUA's first line of supervision when formal action is to be pursued. This type of enforcement action is unique in that it allows for anticipatory action by the NCUA. That is, not only can NCUA act to prevent a recurrence of a practice or a violation, but it can also proceed in anticipation of the credit union's action.

A Cease and Desist action is a means by which NCUA can take strong affirmative action against a solvent credit union and at the same time preserve and strengthen its corporate and managerial integrity.

The issuance of a Cease and Desist Order should be sufficient impetus to compel the credit union to take the desired action. If, however, the examiner believes that compliance would not be effected by issuance of a Final Order, an alternative administrative action should be considered.

A Cease and Desist action is usually a three-step process:

a. Notice of Charges and Hearing (and, when necessary, a Temporary Cease and Desist Order);

b. Hearing; and,

c. Final (and permanent) Cease and Desist Order.

2.2 Grounds

The grounds for a Cease and Desist action are set forth in 12 C.F.R. Section 747.302 as well as in Section 206(e) of the Act. The examiner can recommend that such action be taken if any insured credit union or if any director, officer, committee member, employee, agent, or other person participating in the conduct of the affairs of the credit union is:

a. Engaging in or has engaged in, or the examiner has reasonable cause to believe that the credit union or the person(s) involved are about to engage in, an unsafe or an unsound practice in conducting the business of such credit union; or,

b. Violating or has violated, or the examiner has reasonable cause to believe that the credit union or person(s) involved are about to violate a law, a rule, a regulation, any condition imposed in writing by the NCUA Board, or any written agreement entered into with the NCUA Board.

Recommendations for Cease and Desist Orders will not necessarily be confined to a persisting problem. If a serious problem disclosed for the first time could have a significant adverse impact on the credit union operations and the officials have indicated they will not effect corrective action, a Cease and Desist Order or other administrative remedy may be the appropriate administrative action.

2.3 Notice of Charges and Hearing

The Notice of Charges and Hearing will contain the specific charge and separate facts about the alleged unsafe and unsound practice or violation or anticipated action. The notice will fix a time and a place at which a hearing is to be held to determine whether a Cease and Desist Order should be issued against the credit union. The date for the hearing will be from 30 to 60 days after service of the notice unless an earlier date has been set by NCUA at the request of the credit union. The examiner should caution the credit union as to the seriousness of the notice upon its delivery to the credit union. The officials should also be made aware of the time frame in which they must respond by filing an answer to the allegations, and that the credit union or its representative must file a written notice of appearance with the Administrative Law Judge. These instructions will be included in the notice.

2.4 Final Cease and Desist Order (Permanent)

If the credit union consents to the issuance of the Cease and Desist Order, or if the NCUA Board finds at the hearing or through review of the hearing that the unsafe or unsound practice or violation or anticipated action specified in the Notice of Charges and Hearing has been established, an order to cease and desist from any such practice or violation or anticipated action may be issued and served.

A Cease and Desist Order becomes effective 30 days after service upon the credit union and it remains effective, except to the extent it is stayed, modified, terminated, or set aside by action of the NCUA or a reviewing court. A Cease and Desist Order issued upon consent becomes effective at the time specified in the order.

2.5 Temporary Cease and Desist Order

A Temporary Cease and Desist Order is appropriate when it is determined that the grounds for a Cease and Desist action as specified in the Notice of Charges and

Hearing are likely to:

a. Cause insolvency; or,

b. Cause a substantial dissipation of the assets or the earnings of the credit union; or,

c. Seriously weaken the condition of the credit union; or

d. Otherwise seriously prejudice the interests of the insured members of the credit union before the administrative proceedings set forth in the Notice of Charges and Hearing can be completed.

The Temporary Cease and Desist Order usually accompanies the Notice of Charges and Hearing. In most cases, it will be part of the notice, but it may be a separate document. (There may be instances where it is determined, based on facts developed after a Notice of Charges and Hearing is served, that a Temporary Cease and Desist Order is warranted although it did not previously appear appropriate. The examiner should immediately notify the supervisory examiner of any facts that would support such action.) The Temporary Cease and Desist Order becomes effective upon service and remains effective unless set aside or limited or suspended by a court. Otherwise, it remains effective until completion of the administrative proceedings held as specified in the Notice of Charges and Hearing or until the NCUA dismisses the charges. When a Final Cease and Desist Order is issued against the credit union, the Temporary Cease and Desist Order continues until the effective date of the permanent order.

The credit union or the individual subject to a Temporary Cease and Desist Order may challenge the order by filing suit in a U.S. District Court within 10 days after being served with the order.

3. ASSESSMENT OF CIVIL MONEY PENALTIES (12 U.S.C. Section 206(k)(2); 12 C.F.R. Subpart D Section 747.401)

3.1 Nature and Purpose

This particular type of administrative action is very limited in scope and is primarily punitive rather than remedial in nature. Its purpose is to penalize a party for violating a Cease and Desist Order. (There are criminal penalties for violations of removal or prohibition orders, but they are imposed through the court system.) The maximum penalty is $1,000 per day for each day the violation continues.

3.2 Grounds

There is only one requirement in order to assess a civil money penalty: the credit union, or any director, officer, committee member, employee, agent, or other person participating in the conduct of the credit union's affairs has violated a Cease and Desist Order that has "become final." "Become final" means that all court challenges to

a Temporary Cease and Desist Order or a Final Cease and Desist Order have been exhausted or the time for challenging the actions has expired.

3.3 Notice of Assessment

A written notice of assessment of a penalty sets forth the amount of the penalty and a statement of the law and the facts upon which the penalty is based. The offending party may request a hearing within 10 days of service of the notice.

4. REMOVAL OF OFFICIALS (12 U.S.C. Section 1786(g); 12 C.F.R. Subpart E Section 747.501)

4.1 Nature and Purpose

The administrative action to remove directors, officers, or committee members as provided in Section 206(g) of the Act is available as an initial course of action or as a continuation of a Cease and Desist Order if the officials refuse to comply as directed. Whether the enforcement action is recommended as an initial course or as a continuation of a Cease and Desist Order, it is separate and has its own applicability to particular situations.

In some cases involving a breach of fiduciary duty on the part of the director, the officer, or the committee member, removal of the person will become an internal matter and will be accomplished by the board of directors. There may be occasions when the director, the officer, or the committee member will voluntarily resign. Such situations may occur when shortages are discovered or when losses are incurred and a resultant investigation by the credit union discloses a specific person to be responsible. If, however, it is apparent the problem cannot or will not be resolved internally or voluntarily, it will be necessary to initiate formal removal proceedings.

The action to remove officials will be considered when an official's individual action is deemed detrimental to the credit union or to the interests of its members or when it creates a potential loss to the NCUSIF.

A director, an officer, or a committee member of an insured credit union also may be removed for conduct or for practice with respect to another insured credit union or other business institution. The conduct or the practice must have resulted in substantial financial loss or in other damage to the other insured credit union or business institution and must evidence personal dishonesty or unfitness on the part of the director, the officer, or the committee member. (For a discussion of the type of information to be included with a recommendation for administrative action, see paragraph 5.1.)

Removal of a director, an officer, or a committee member is not anticipatory in nature as in the cease and desist action. It can be used only when an official has committed an act which constitutes grounds for removal. Removal can follow only if a Notice of Intent to Remove or a Notice of Suspension and Intent to Remove has been issued and after the appropriate administrative proceedings as provided in the NCUA Rules and Regulations have been completed.

4.2 Grounds

a. A director, an officer, or a committee member can be removed from office if such person:

(1) Has committed any violation of law, rule, regulation, or Final Cease and Desist Order; or,

(2) Has engaged in or has participated in any unsafe or unsound practice in connection with the credit union; or,

(3) Has committed or engaged in any act, omission, or practice which constitutes a breach of duty as an official; AND, either:

(a) The credit union suffered or will probably suffer substantial financial loss or other damage; or,

(b) The members' interests could be seriously prejudiced by the official's action.

It must be determinable with reasonable certainty that the credit union has suffered or will probably suffer substantial financial loss or other damage or that the interests of its members could be seriously prejudiced by reason of such violation, practice, or breach of fiduciary duty.

b. Removal can also be based on grounds that the director, the officer, or the committee member of an insured credit union, by conduct or by practice with respect to another credit union or business institution, caused substantial financial loss or other damage. Sufficient evidence must be presented to show personal dishonesty or unfitness to continue as a director, an officer, or a committee member.

c. An official can also be removed for any violation of the Depository Institution Management Interlocks Act.

4.3 Notice of Intent to Remove

The notice to remove an official from office will contain a statement of facts constituting the grounds for removal and will fix a time and a place at which a hearing will be held. Normally, the hearing will be held between 30 days and 60 days after the date such notice is served.

The rules and the procedures contained in Part 747, subpart E, of the NCUA Rules and Regulations are applicable to suspension and removal actions. The examiner should inform the official upon delivery of the notice that unless such director, officer, or committee member appears at the hearing in person or is represented by an authorized representative, that person will be deemed to have consented to the issuance of an Order of Removal.

4.4 Immediate Suspension of an Official

An immediate suspension is similar in design and in purpose to a Temporary Cease and Desist Order. If it is necessary to protect the credit union or the interests of its members, an official may be immediately suspended from all official duties pending completion of the proceedings called for in the Notice of Intent to Remove. This would be appropriate, for example, when it appears that the individual, once served with a notice, could cause further loss to the credit union or could destroy credit union records before the hearing is completed or the NCUA Board issues its final Order of Removal. Like a Temporary Cease and Desist Order, an Immediate Suspension will usually be a part of or will be served simultaneously with the Notice of Intent to Remove, although it may be served any time after the notice. It, too, becomes effective immediately upon service and remains in effect until dismissed or until a final order is issued by the NCUA Board. It may also be challenged in court within 10 days of service.

5. PROHIBITIONS (12 U.S.C. 1786(g); 12 C.F.R. Subpart E Section 747.501)

5.1 Nature and Purpose

A prohibition action is similar to a removal proceeding but is broader in scope. A removal action is designed to remove a person from a specified official position in a credit union, while a prohibition action is designed to stop any individual who participates in the credit union's affairs from continuing to do so. Because individuals who participate in the conduct of the affairs of an insured credit union may not be elected or appointed officials of an insured credit union, they cannot be removed as directors, officers, or committee members. Instead, they may be prohibited from further participation in the affairs of an insured credit union. A person's withdrawal from further participation in the conduct of an insured credit union may not necessarily preclude the NCUA from seeking an enforcement action. The NCUA may proceed to prohibit that person from further participation if that person's conduct or practice resulted in substantial financial loss or other damage to the credit union, to another insured credit union, or to another business institution.

Generally, a prohibition action will be taken against a person who is not a director, an officer, or a committee member, but who is involved with the credit union in some other capacity, such as an employee, an agent, or an attorney. If the offending person functions as both an official and an employee, however (for example, an individual serving on the board of directors and hired as an assistant manager), then both a removal and a prohibition action would be appropriate. One action would remove the individual from the elected position and the other would prevent continuing involvement in the credit union's operations as an employee or in any other capacity.

A recommendation by the examiner for a prohibition action will be prepared in the same manner as other administrative actions. The examiner will need to include:

a. The name of the person recommended to be prohibited, business address, and position with the company, group or enterprise (including name of the proprietorship, partnership, or corporation);

b. Sufficient evidence to support the allegation of conduct or practice to show personal dishonesty or unfitness; and,

c. How the credit union, the other insured credit union, or the other business enterprise suffered substantial financial loss or other damage.

Prohibition of a person, like a removal of an official, is not anticipatory in nature as in a cease and desist action. Prohibition can follow only if a Notice Intent to Prohibit has been issued and after completion of the appropriate administrative proceedings.

5.2 Grounds

Any person, including a business entity, who participates in the conduct of the affairs of an insured credit union may be prohibited from further participation. It is necessary to show that the person's conduct or practice with respect to that credit union, to another insured credit union, or to another business institution:

a. Resulted in substantial financial loss or other damage; and,

b. Evidenced personal dishonesty or unfitness to continue participation with the credit union.

It should be noted that the phrase "any other person participating in the conduct of the affairs of an insured credit union" as used in the Act is not susceptible of a precise definition. The Agency's position is that it covers any person who takes part in or who influences the manner in which the credit union conducts its business. One court has, however, limited its applicability to persons involved in internal management and not to persons outside the credit union. Athough the Agency still views the language as being broader in scope, any questions regarding whether or not a particular person can be subject to a prohibition action should be directed to the supervisory examiner.

5.3 Notice of Intent to Prohibit a Person from Further Participation

When the NCUA determines that grounds for a prohibition action exist, a Notice of Intent to Prohibit a person from further participation will be served upon that person. The notice will be based on the grounds that the person participating in the conduct of the affairs of an insured credit union, by conduct or by practice with respect to such credit union, to another insured credit union, or to another business institution, caused substantial financial loss or other damages, which evidences personal dishonesty or unfitness to continue to participate in the affairs of the credit union.

NCUA is not precluded from issuing a notice where the person voluntarily withdraws or whose services were terminated by the credit union after financial losses or other damages to the credit union were revealed through admissions or investigations.

Such action under these circumstances may be warranted in cases where that person continues to participate in the affairs of other insured credit unions but substantial financial loss or other damage in these credit unions is not yet evident.

The examiner will inform the person served with the notice of the basic requirements with respect to the hearing as stated in the notice. The hearing will be held not less than 30 days and not more than 60 days after delivery of the notice. Usually, the examiner will be directed to complete a follow-up supervision contact prior to the hearing date. However, if a contact is not made or additional pertinent information relative to the person and the charges cited in the notice become known to the examiner prior to the hearing, this information should be reported to the regional office as soon as possible. The examiner should expect to participate in the hearing as a witness for NCUA.

5.4 Immediate Prohibition

An immediate prohibition order may be issued to protect the credit union or the interest of its members on the same basis and for the same reasons as an immediate removal of official order. The discussion in paragraph 4.4 above is equally applicable here.

6. REMOVAL OF AN OFFICIAL OR PROHIBITION OF A PERSON WHERE FELONY IS INVOLVED (12 U.S.C. Section 1786(i); 12 C.F.R. Subpart F, Section 747.601)

The examiner should be alert to any reported complaints or indictments brought against officials alleging or involving dishonesty or breach of trust. The examiner should report any evidence supporting a possible felony to the supervisory examiner. In no instances should the examiner proceed to investigate any complaints or indictments brought against officials or other persons participating in the conduct of a credit union's affairs without first consulting with the supervisory examiner.

If the U.S. Attorney or an enforcement agency verifies in writing that an official or other person has been charged with a crime involving dishonesty or breach of trust, and the crime is one which is punishable under federal and state law by imprisonment for more than 1 year, the examiner will report the findings in support of a recommendation to suspend the official or to prohibit the person from further participation in any manner in the conduct of the affairs of the credit union as provided in Section 206(i) of the Act. Tangible evidence must be developed to show the individual's continued service or participation in the credit union may:

a. Pose a threat to the interest of the credit union's members; or,

b. Threaten to impair public confidence in the integrity, the safety, or the soundness of the credit union.

Examples of such tangible evidence could be circumstances and events, such as a membership meeting called in an attempt to force the resignation of the official or the

termination of a person's participation, or share outflows, and/or membership cancellations, that are directly attributed to general membership dissatisfaction over the continuation of the person as an official, or the credit union is unable to obtain loans from regular sources, which can be attributed directly to the continuation of the person as an official.

The examiner should refrain from expressing an opinion of guilt or of innocence in the recommendation for suspension or for prohibition. The suspension or the prohibition remains in effect until the information, the indictment, or the complaint is finally disposed of, or until it is terminated by NCUA.

If a final verdict of guilty is reached, and at such time as the judgment is not subject to further appellate review, NCUA may issue and have the examiner serve upon the person an order removing that person from office or prohibiting that person from further participation in the conduct of affairs of the credit union. A not guilty verdict will not preclude NCUA from instituting proceedings to remove such official or to prohibit such person from participating in the affairs of the credit union under the general removal and prohibition provisions previously discussed. The examiner will need to maintain close follow-up on the proceedings and immediately report to the supervisory examiner any new developments which may affect the order issued or pending.

7. CONSERVATORSHIP (12 U.S.C. Section 1786(h))

7.1 Nature and Purpose

Conservatorship is a procedure whereby the Agency takes immediate possession and control of a credit union's business and assets and may operate the credit union until:

a. The NCUA Board permits it to resume business on its own, subject to any terms or conditions the Board may impose;

b. The NCUA Board transfers possession and control to a state authority (in the case of a federally insured state-chartered credit union); or,

c. The credit union is liquidated.

Conservatorship is a particularly useful tool in situations where management has abandoned the credit union or is totally inadequate to cope with severe financial problems that must be immediately brought under control or there will be serious deterioration in the credit union's operations. Conservatorship allows the Agency to more actively influence the operations of the credit union and to avoid or substantially reduce any further dissipation of assets. It is also useful in situations where there is evidence of complex illegal or unsafe practices, but the full ramifications of this activity cannot be readily determined. It precludes management from having any access to records and, thus, avoids the chance that vital records can be tampered with or destroyed. At the same time, it permits member services to continue, although such services may be somewhat limited. Ideally, conservatorship will result in the credit union ultimately being returned to the members' control.

Unlike the previous forms of action discussed, conservatorship does not involve an administrative hearing. The NCUA Board may act ex parte without notice, meaning it need not notify the credit union of its intended action or provide it with the opportunity to contest the action before it is taken. Within 10 days after a credit union is placed into conservatorship, however, the action may be challenged in U.S. District Court.

7.2 Grounds

Conservatorship action may be taken when:

a. It is necessary to conserve the assets of the insured credit union;

b. It is necessary to protect the NCUSIF;

c. It is necessary to protect the interests of the members; or,

d. By resolution of its board of directors, the credit union consents to conservatorship.

7.3 State Credit Unions

In the case of a federally insured state credit union, the Act provides that written approval of the state regulatory authority is a prerequisite to a conservatorship action. However, if the state does not provide such approval within 90 days of the NCUA Board's notice that grounds for conservatorship exist and the Board responds in writing to any written reason if and why the state is withholding approval, then, upon a unanimous vote of the NCUA Board, the credit union can be placed into conservatorship without state approval.

8. TERMINATION OF INSURANCE (12 U.S.C. Section 1786(a))

8.1 Nature and Purpose

Although this action can technically be initiated against a federal credit union, it is generally reserved for federally insured state-chartered credit unions. Due to the fact that federal credit unions must be federally insured, a termination of insurance would result in liquidation unless the credit union could convert to a state charter prior to completion of the proceeding. Therefore, the recommended course of action for a federal credit union is immediate liquidation, if insolvent, or Suspension and/or Notice of Intent to Place into Involuntary Liquidation, for problems other than insolvency. See sections 9 and 10 below.

For federally insured state-chartered credit unions, this is the most severe action that can be initiated by NCUA. It is somewhat punitive in nature, although it is designed

to protect the NCUSIF when the credit union is unwilling to take corrective action. In this regard, its purpose is similar to one of the bases for a conservatorship.

This action will most likely force the state credit union into involuntary liquidation unless an alternative share insurance program is available, the credit union can qualify, and membership confidence can be maintained. For these reasons, the regional office will be in close communication with the state regulatory agency whenever any administrative action is being contemplated against any federally insured state credit union. The examiner will not discuss the potential for an administrative action with the credit union or with the state regulatory agency unless specifically directed to do so by the supervisory examiner or by the regional director.

8.2 Grounds

The grounds for a termination of insurance action are essentially the same as those for a cease and desist action:

a. Unsafe or unsound practices or conditions; and ,

b. Violations of law, rule, regulation, any condition imposed in writing by the NCUA Board, or any written agreement entered into with the NCUA Board.

Unlike a cease and desist action, however, it cannot be used in anticipation of violations or unsafe practices.

Termination of insurance action is available as an initial course of action or as a continuation of a Cease and Desist Order if the officials refuse to comply as directed. Conditions in an operating federally insured state credit union that would warrant a recommendation for termination of share insurance are, but are not limited to:

a. Insolvency as defined in 700.1(k) of the NCUA Rules and Regulations, and the credit union's board of directors or the state regulatory agency will not initiate action to place the credit union into involuntary liquidation or take appropriate measures to minimize the risk and the potential for loss to the NCUSIF; or,

b. Abandonment of the credit union's operations and affairs by the elected and the appointed officials, and the state regulatory agency will not initiate action to minimize the risk and the potential for loss to the NCUSIF; or,

c. Plant closing, extended work stoppage, or breakdown in membership confidence that is causing a major outflow of shares and of liquidity or general mismanagement of the operations and the affairs by the officials that is causing or will cause an insolvent condition, and the officials or the state regulatory agency will not initiate action to minimize the risk and the potential for loss to the NCUSIF; or,

d. An unsafe or an unsound practice or a serious violation of an applicable law, rule, regulation, order, or any condition imposed by the NCUA Board that is causing or will cause an insolvent condition, and the officials or the state regulatory agency will not initiate action to minimize the risk and the potential for loss to the NCUSIF.

8.3 Notice of Charges

As a preliminary step to a Notice of Intent to Terminate Insured Status, NCUA, if conditions warrant, will issue a Notice of Charges to the credit union, with a copy to the state regulatory agency. This notice will contain a statement describing the unsafe or unsound practice(s), condition(s) or the relevant violations. This notice will request that the credit union correct the practice, the condition, or the violation within 120 days after service of the notice. A shorter time frame of not less than 20 days may be set if NCUA considers any further delay may unduly subject the NCUSIF to greater risk or if the state regulatory agency requires a time frame shorter than 120 days.

This warning may be sufficient to motivate the officials to take the necessary corrective action. The examiner may be assigned to investigate the circumstances and the events in the case as a preliminary step in the process of issuing a Notice of Charges. In such an event, the examiner will need to clearly and specifically identify the specific unsafe or unsound practices or serious violations and provide the facts that will support each, which will constitute the grounds for the action. The examiner's analysis and evaluation of the circumstances and the events in the case should be of sufficient depth that, if the credit union fails to correct the conditions cited in the Notice of Charges, there will be sufficient evidence to proceed with the Notice of Intent to Terminate Insured Status.

8.4 Notice of Intent to Terminate Insured Status

If NCUA determines to proceed further with the action, a Notice of Intent to Terminate Insured Status will be issued. This notice will contain a statement of the facts about the alleged unsafe or unsound practice or violation and shall fix the time and the place at which a hearing is to be held. The date of the hearing will be from 30 to 60 days after service of the notice unless an earlier date has been set by the NCUA at the request of the credit union. The examiner, if assigned to the case, should caution the credit union as to the seriousness of the notice upon its delivery to the credit union. A copy of the notice will also be made available to the state regulatory agency. The examiner will inform the officials of the time frame in which they must respond to the allegations and that the credit union or its representative must file a written notice of appearance with the Administrative Law Judge. These instructions will be included in the notice.

8.5 Notice of Termination of Insured Status

If a credit union cannot be returned to satisfactory operations and the danger of insolvency eliminated, its insured status will be terminated. The determination will be made at a hearing held pursuant to the NCUA Rules and Regulations. Prior to the effective date of the termination of the insured status of a federally insured state credit union, the credit union is required to mail to each member and to publish in a newspaper of general circulation the Notice of Termination of Insured Status. The format for the notice is specified in the NCUA Rules and Regulations. Specific duties of the credit union after termination of share insurance also are specified in the NCUA Rules and Regulations. An examiner may be assigned the task of following up on the issuance of

the notice to determine if the credit union is fulfilling its duties and its obligations to its members and to the NCUSIF. The credit union is also subject to the same duties and obligations of an insured credit union for 1 year from the effective date of the Notice of Termination of Insured Status.

9. INVOLUNTARY LIQUIDATION (Insolvent) (12 U.S.C. Section 1787(a)(1))

9.1 Nature and Purpose

Section 207(a)(1) of the Act empowers the NCUA Board to close a federal credit union upon its finding that the credit union is bankrupt or insolvent. The ultimate effect of this form of administrative action is the elimination of the credit union as a legal entity. It is to be used in those situations where the credit union is no longer financially viable and financial assistance from NCUA would not be possible.

9.2 Grounds

This most severe action will be taken whenever a federal credit union is declared insolvent or bankrupt as defined in Section 700.1(k) of the NCUA Rules and Regulations.

There will be no preclosure administrative hearing in a finding of insolvency. The federal credit union's charter will be revoked and the credit union placed into involuntary liquidation. It is critical, therefore, that the finding of insolvency be based upon an array of tangible evidence and of indisputable circumstances. These facts and circumstances must be based on the most current information available in the form of an examination report, with a supplemental memorandum prepared that includes all significant data to support the recommended action.

9.3 Notice of Revocation of Charter and Involuntary Liquidation; Appointment of Agent

The notice will be served upon the federal credit union in the same manner as previously discussed for the final notices in a solvent federal credit union. In this case, however, an Agent for the Liquidating Agent will be appointed as provided in Sections 120(b)(1) and 207(a)(3) of the Act, and a payout from the NCUSIF will commence.

10. REVOCATION OF CHARTER AND INVOLUNTARY LIQUIDATION (SOLVENT) (12 U.S.C. Section 1766(b)(1))

10.1 Nature and Purpose

The ultimate effect of this form of enforcement action is the elimination of the credit union as a legal entity after due process of the rules and the procedures contained in Part 747, subpart G of the NCUA Rules and Regulations. It is the most drastic

enforcement action that can be exercised against a solvent federal credit union. This most severe action will be taken whenever a federal credit union has committed the most serious and irreversible violations of any provisions of its charter, its bylaws, the Act, or any regulation.

10.2 Grounds

Pursuant to the authority in Section 120(b)(1) of the Act, the NCUA Board may suspend the charter of a federal credit union that has violated any provision of its charter, its bylaws, the Act, or any regulation. Note that this type of action may also be taken for reasons of insolvency. However, the procedure for issuance of this type action for reason of insolvency differs. Conditions in an operating credit union that would warrant a recommendation for revocation of charter are:

a. Abandonment of the credit union's operations and affairs by the elected and the appointed officials; or,

b. Plant closing and officials refusing to vote to present the question of liquidation to the members. Such plant closing may force insolvency under the concept of an on-going concern, or may cause a dissipation of the assets and expose the creditors and the NCUSIF to a greater than normal risk; or,

c. Other specific serious violation of its charter, its bylaws, the Act, or regulations that cannot be reversed and that will cause an insolvent condition; or,

d. Failure to promptly replace lost surety coverage.

Abandonment shall be deemed to have occurred when all or most of the elected and the appointed officials have demonstrated by their actions, or failure to act, an intent to end operations. In those instances where less than a quorum of the board of directors continues to act on behalf of the credit union, abandonment requires a showing that an active quorum cannot or will not be formed by the remaining officials.

Because of the significant impact revocation of charter will have on the membership, the examiner should make certain that the grounds for such a recommendation are indisputable and represent the most logical solution to the credit union's problems. For this reason, revocation of charter actions will not be initiated without current information about the credit union in the form of a recent examination or supervision report, with a supplemental memorandum, detailed information, and all significant data to support the recommended action.

10.3 Notice of Intent to Revoke Charter and Place Into Involuntary Liquidation

A Notice of Intent to Revoke Charter will be recommended by the examiner whenever the time frame for due process will not create a greater risk of loss to the members, the creditors, and the NCUSIF than that existing at the time of recommendation. The examiner should be aware that the credit union will continue to conduct business during the effective time period of this type of notice. Whether or not

a greater risk for loss exists by allowing the credit union to conduct business in the interim will be determined by the examiner based on the conditions and the circumstances in each case. However, if a greater risk for loss is likely to exist, a recommendation for a Notice of Suspension of Charter and Intent to Revoke Charter and Place Into Involuntary Liquidation may be appropriate. This action is discussed in the following subsection.

The credit union has 40 days from the date the notice is served to:

a. File a written statement with NCUA setting forth the reasons why it should not be placed into involuntary liquidation; or,

b. In lieu of a written statement, request an oral hearing conducted in accordance with Part 747 of the NCUA Rules and Regulations; or,

c. Affirmatively consent to the Notice by resolution of the board of directors.

The written statement, request for an oral hearing, or consent must be accompanied by a certified copy of resolution by the board, signed by the president and the secretary authorizing such statement, request, or consent.

At the time of delivery of the action, the examiner will advise the officials of their options and of the time frames within which their options must be exercised. The examiner must make it known to the officials that if the credit union fails to exercise any of its alternatives as provided in the NCUA Rules and Regulations within the prescribed time frames, it will be deemed to have consented to the action being sought by NCUA.

10.4 Notice of Suspension of Charter and Intent to Revoke Charter and Place into Involuntary Liquidation

An immediate suspension of charter will be recommended by the examiner whenever it is necessary that NCUA take immediate action to protect the interests of the members, the creditors, and the NCUSIF. Such a notice will be necessary to prevent further dissipation of the credit union's assets or earnings or to prevent further weakening of its condition or to otherwise protect the interests of the credit union's insured members or the NCUSIF. All business by the credit union ceases except for the collection of loans, interest, and late charges; the collection of other funds legally due the credit union; and the payment of accounts payable and necessary operating expenses. The officials may be permitted to continue to manage and to operate the credit union under these restrictions, or the NCUA may take immediate possession of all records and property of the credit union.

The Notice of Suspension of Charter will contain a statement of the grounds for the immediate suspension and the authority upon which such grounds are based. Except for this statement of the grounds supporting the need for immediate suspension of the charter and the restrictions placed on operations, the options available and the explanation of results which will occur if the credit union fails to exercise its options will be the same as written in a Notice of Intent to Revoke Charter.

10.5 Appointment of Agent

A recommendation by the examiner that NCUA appoint an agent to take possession of all books, records, assets, and property of the credit union will be appropriate whenever it is apparent to the examiner that the officials are unwilling or unable to cope with the serious problems confronting their credit union that provided the grounds for the immediate suspension of the charter. A complete breakdown in the maintenance of the books and the records or abandonment of the credit union by the officials will be sufficient grounds to recommend an appointment of an agent.

The appointed agent usually will be the district examiner responsible for the supervision of the credit union. The duties of the examiner will be carried out under the direction of the supervisory examiner during the period the credit union's charter is under suspension and will be limited to the collection of loans, interest, and late charges; the collection of other funds legally due the credit union; and the payment of accounts payable and necessary operating expenses. In addition, the agent will maintain, or have maintained, the records of the credit union in a current condition and will arrange to have the credit union open for restricted business activity as necessary to carry out the agent's duties. The agent also will be responsible for having the credit union's surety bond coverage extended to cover the agent for the NCUA Board and to arrange with the credit union's depository to honor the signature of the agent.

The duration of the agent's responsibility will extend up to the time the credit union is place into involuntary liquidation, the administrative action is withdrawn, or the appointment is rescinded, whichever comes first.

10.6 Notice of Continuance

If the examiner is convinced that reasonable progress is being made in the elimination of the serious problems but that more time is needed for the officials to prove their willingness and their ability to remove the conditions that threaten the members, the creditors, and the NCUSIF, the officials may request an extension of time. In no event, however, should the examiner take the initiative in encouraging the officials to make a request without first obtaining approval from the supervisory examiner. A written request for an extension should come from the credit union's officials and not from the examiner. However, the examiner will need to comment on the feasibility of such a request and to recommend for or against the request based on substantive support developed during the supervision contact.

Except in very unusual circumstances, a continuance will be authorized only once and for a period of not more than 90 to 120 days from expiration of the credit union's 40-day response period. It is not the intent of NCUA that a continuance extend the credit union's rights and privileges in the notice beyond the 40-day period from delivery as written in the notice and as promulgated in the NCUA Rules and Regulations.

10.7 Notice of Termination

If the credit union officials have eliminated the serious problems cited in the notice, a termination of the administrative action may be warranted. Documentation must be presented supporting the conclusion that the charges cited in the notice no longer exist.

10.8 Notice of Revocation of Charter and Involuntary Liquidation; Appointment of Agent

Liquidation may be the only alternative if a credit union under an administrative action cannot be returned to satisfactory operations. NCUA ordinarily will appoint the regional liquidation specialist as the liquidating agent in involuntary liquidations of credit unions closed for reasons other than insolvency. In certain cases, examiners will be appointed as agents where geography or other factors preclude the liquidation specialist from handling the liquidation.

This final action will be taken sometime after 40 days from delivery of the Notice of Intent to Revoke Charter or of the Notice of Suspension of Charter and Intent to Revoke Charter and Place Into Involuntary Liquidation to the credit union. The examiner's recommendation to proceed with this final action will be supported by appropriate schedules and workpapers prepared on or soon after the 40th day. The report should include specific comments and pertinent information on each charge cited in the notice.

The examiner also should report whether the credit union exercised any of the options available to it. If the credit union filed a statement setting forth grounds and reasons why its charter should not be suspended, its response will be objectively analyzed by the examiner. Factual evidence will be provided to support or to reject these grounds and the reasons as they relate to the charges.

11. ORDER TO ESTABLISH SPECIAL RESERVE FOR LOSSES

11.1 Nature and Purpose

Sections 116 and 201 of the Act authorize the NCUA Board to require that special reserves be established when necessary to protect the interests of federal credit union members. In addition, state-chartered federally insured credit unions agree in the Application and Agreement for Insurance of Accounts to establish such reserves as the NCUA Board may determine are necessary.

The order requires that the reserves be established in an account entitled "Special Reserve for Losses" and that they not be transferred from that account or be reduced in any way except by written permission of the NCUA Board or upon termination of the order. Generally, the order will affect the credit union's ability to pay dividends.

An Order to Establish Special Reserve for Losses may be necessary under the following conditions:

a. When the established reserves do not provide sufficient protection against a condition which threatens the credit union's soundness;

b. When it is believed that the credit union may intentionally evade the need to establish sufficient reserves;

c. When it is believed that the credit union may ignore the need for additional reserves; or,

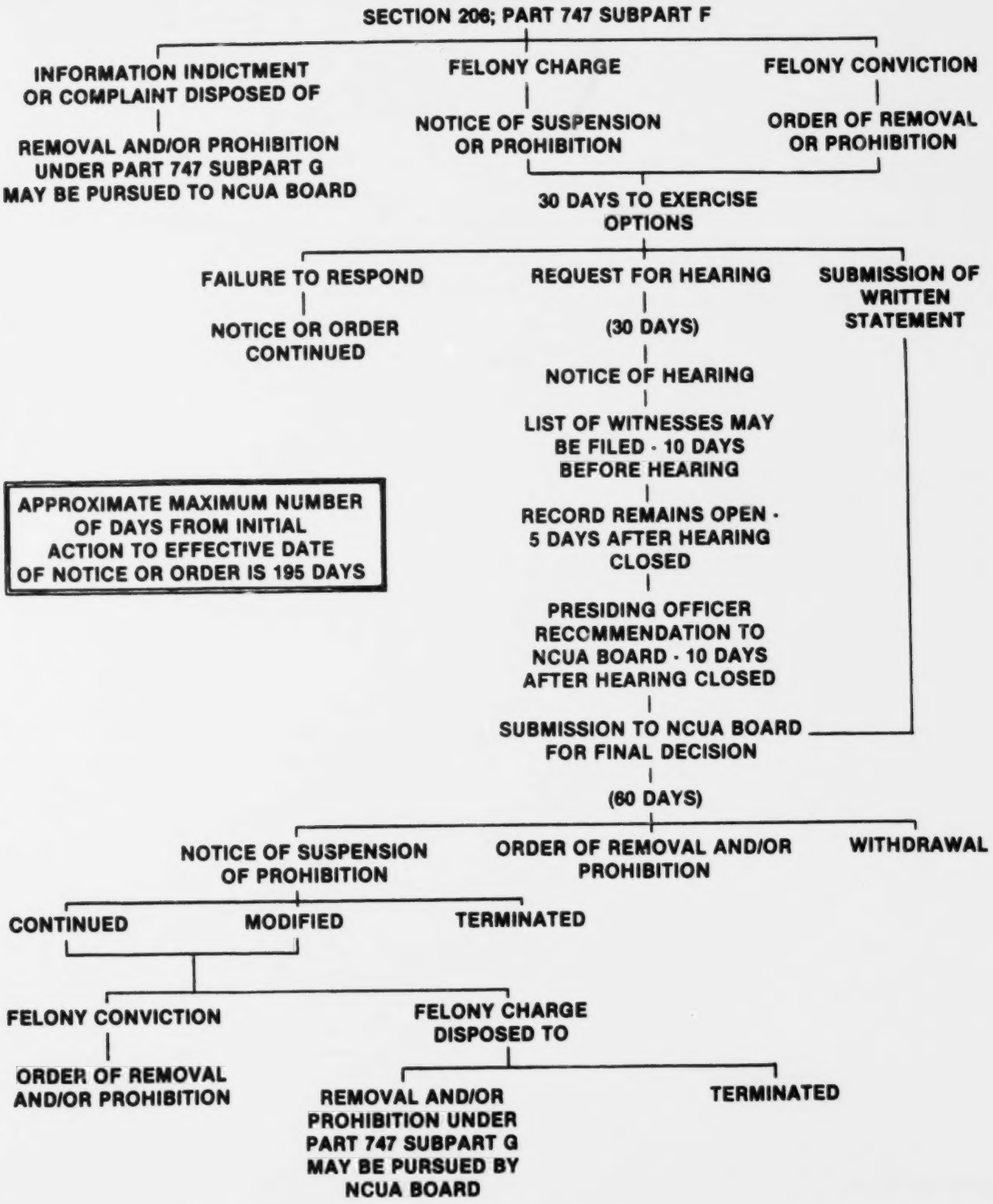
d. When it is believed that the credit union may avoid the establishment of sufficient reserves by unrealistically refinancing or extending loans or by intentional misrepresentation of facts that, if properly disclosed, would have a material effect on the financial position of the credit union.

The Order to Establish Special Reserve is designed to prevent further deterioration of the credit union's financial condition. Changes in reserve structure resulting from an order can be accomplished equally as well as by voluntary action of the officials. Before recommendation is made for issuance of an order, the examiner should determine that every effort has been made to prompt action by the board of directors to voluntarily transfer to an allowance for reserve account the amount contemplated for establishment in the Special Reserve for Losses.

11.2 Recommending Special Reserve for Losses

The regional director's recommendation to the NCUA Board for Special Reserve for Losses will usually be based on the establishment of data compiled by the examiner during an examination or a supervision contact after consulting with the supervisory examiner and with the latter's concurrence. The basis for the recommendation should be set forth in a separate memorandum or in an NCUA 2970 attached to the examination or to the EWSA report, with references to the appropriate sections in the report. These reports should be flagged to ensure prompt processing by the regional office.

SUSPENSION AND REMOVAL OR PROHIBITION OF DIRECTORS, OFFICERS, COMMITTEE MEMBERS OR OTHER PERSONS - FELONY CHARGE OR CONVICTION


SECTION 206; PART 747 SUBPART F
INFORMATION INDICTMENT OR COMPLAINT DISPOSED OF
REMOVAL AND/OR PROHIBITION UNDER PART 747 SUBPART G MAY BE PURSUED TO NCUA BOARD
FELONY CHARGE
NOTICE OF SUSPENSION OR PROHIBITION
FELONY CONVICTION
ORDER OF REMOVAL OR PROHIBITION
30 DAYS TO EXERCISE OPTIONS
FAILURE TO RESPOND
NOTICE OR ORDER CONTINUED
REQUEST FOR HEARING
(30 DAYS)
NOTICE OF HEARING
LIST OF WITNESSES MAY BE FILED - 10 DAYS BEFORE HEARING
RECORD REMAINS OPEN - 5 DAYS AFTER HEARING CLOSED
PRESIDING OFFICER RECOMMENDATION TO NCUA BOARD - 10 DAYS AFTER HEARING CLOSED
SUBMISSION OF WRITTEN STATEMENT
SUBMISSION TO NCUA BOARD FOR FINAL DECISION
(60 DAYS)
NOTICE OF SUSPENSION OF PROHIBITION
ORDER OF REMOVAL AND/OR PROHIBITION
WITHDRAWAL
CONTINUED
MODIFIED
TERMINATED
FELONY CONVICTION
ORDER OF REMOVAL AND/OR PROHIBITION
FELONY CHARGE DISPOSED TO
REMOVAL AND/OR PROHIBITION UNDER PART 747 SUBPART G MAY BE PURSUED BY NCUA BOARD
TERMINATED
APPROXIMATE MAXIMUM NUMBER OF DAYS FROM INITIAL ACTION TO EFFECTIVE DATE OF NOTICE OR ORDER IS 195 DAYS

TERMINATION OF INSURED STATUS

SECTION 206; PART 747 SUBPART B

NOTICE OF CHARGES

COPY TO STATE COMMISSION BOARD OR AUTHORITY

(120 DAYS)

NOTICE OF INTENT TO TERMINATE INSURED STATUS AND NOTICE OF HEARING

(30 TO 60 DAYS)

HEARING

CONSENT

ORDER TERMINATING INSURED STATUS

(30 DAYS)

TRANSCRIPT COMPLETED

NOTICE OF TRANSMITTAL TO ADMINISTRATIVE LAW JUDGE

(15 DAYS)

ADDITIONAL INFORMATION MAY BE FILED

(30 DAYS)

RECOMMENDED DECISION ADMINISTRATIVE LAW JUDGE FILED WITH NCUA BOARD: NOTIFICATION OF SUCH DECISION TO PARTIES

(15 DAYS)

EXCEPTION TO RECOMMENDED DECISION MAY BE FILED

(10 DAYS)

FILING OF REPLY BRIEFS

ORAL ARGUMENT DISCRETIONARY

SUBMISSION TO NCUA BOARD FOR FINAL DECISION

(90 DAYS)

FINAL ORDER TERMINATING INSURED STATUS

CANCELLATION OF INSURANCE AFTER 1 YEAR FROM EFFECTIVE DATE OF TERMINATION OF INSURED STATUS

WITHDRAWAL

APPROXIMATELY MAXIMUM NUMBER OF DAYS FROM INITIAL ACTION TO EFFECTIVE DATE OF ORDER IS 370 DAYS

CEASE AND DESIST

SECTION 206; PART 747 SUBPART C

(15 DAYS FOR OBTAINING ADMINISTRATIVE LAW JUDGE AND SETTING TIME AND PLACE OF HEARING)

NOTICE OF CHARGES AND HEARING

TEMPORARY ORDER

(30 TO 60 DAYS)

10 DAYS TO APPLY FOR INJUNCTIVE RELIEF

HEARING

CONSENT

(30 DAYS)

ISSUANCE OF CEASE AND DESIST ORDER

TRANSCRIPT COMPLETED

NOTICE OF TRANSMITTAL TO ADMINISTRATIVE LAW JUDGE

(15 DAYS)

APPROXIMATELY MAXIMUM NUMBER OF DAYS FROM INITIAL ACTION TO EFFECTIVE DATE OF ORDER IS 295 DAYS

ADDITIONAL INFORMATION MAY BE FILED

(30 DAYS)

RECOMMENDED DECISION ADMINISTRATIVE LAW JUDGE FILED WITH NCUA BOARD: NOTIFICATION OF SUCH DECISION TO PARTIES

(15 DAYS)

EXCEPTIONS TO RECOMMENDED DECISION MAY BE FILED

(10 DAYS)

FILING OF REPLY BRIEFS

ORAL ARGUMENT DISCRETIONARY

SUBMISSION TO NCUA BOARD FOR FINAL DECISION

(90 DAYS)

FINAL ORDER (EFFECTIVE IN 30 DAYS)

WITHDRAWAL

CANCELLATION OF CHARTER

SECTION 120; PART 747 SUBPART C

NOTICE OF SUSPENSION OF CHARTER AND INTENT TO PLACE INTO INVOLUNTARY LIQUIDATION

NOTICE OF INTENT TO REVOKE CHARTER AND PLACE INTO INVOLUNTARY LIQUIDATION

NOTICE OF REVOCATION OF CHARTER AND INVOLUNTARY LIQUIDATION (INSOLVENCIES)

40 DAYS TO EXERCISE OPTIONS

CONSENT

REVOCATION OF CHARTER AND INVOLUNTARY LIQUIDATION

CANCELLATION OF CHARTER

REQUEST FOR HEARING

(15 DAYS)

NOTICE OF HEARING

(30 TO 60 DAYS)

HEARING

(30 DAYS)

TRANSCRIPT COMPLETED NOTICE OF TRANSMITTAL TO ADMINISTRATIVE LAW JUDGE

(15 DAYS)

ADDITIONAL INFORMATION MAY BE FILLED

(30 DAYS)

RECOMMENDED DECISION ADMINISTRATIVE LAW JUDGE FILED WITH NCUA BOARD: NOTIFICATION OF SUCH DECISION TO PARTIES

(15 DAYS)

EXCEPTIONS TO RECOMMENDED DECISION MAY BE FILED

(10 DAYS)

FILING OF REPLY BRIEFS

ORAL ARGUMENT DISCRETIONARY

SUBMISSION TO NCUA BOARD FOR FINAL DECISION

(90 DAYS)

REVOCATION OF CHARTER AND INVOLUNTARY LIQUIDATION

CANCELLATION OF CHARTER

SUBMISSION OF WRITTEN STATEMENT

APPROXIMATE NUMBER OF DAYS FROM NOTICE TO DATE OF FINAL ORDER IS 305

TERMINATION OF INSURED STATUS

SECTION 206; PART 747 SUBPART B

NOTICE OF CHARGES

COPY TO STATE COMMISSION BOARD OR AUTHORITY

(120 DAYS)

NOTICE OF INTENT TO TERMINATE INSURED STATUS AND NOTICE OF HEARING

(30 TO 60 DAYS)

HEARING

CONSENT

ORDER TERMINATING INSURED STATUS

(30 DAYS)

TRANSCRIPT COMPLETED

NOTICE OF TRANSMITTAL TO ADMINISTRATIVE LAW JUDGE

(15 DAYS)

ADDITIONAL INFORMATION MAY BE FILED

(30 DAYS)

RECOMMENDED DECISION ADMINISTRATIVE LAW JUDGE FILED WITH NCUA BOARD: NOTIFICATION OF SUCH DECISION TO PARTIES

(15 DAYS)

EXCEPTION TO RECOMMENDED DECISION MAY BE FILED

(10 DAYS)

FILING OF REPLY BRIEFS

ORAL ARGUMENT DISCRETIONARY

SUBMISSION TO NCUA BOARD FOR FINAL DECISION

(90 DAYS)

FINAL ORDER TERMINATING INSURED STATUS

CANCELLATION OF INSURANCE AFTER 1 YEAR FROM EFFECTIVE DATE OF TERMINATION OF INSURED STATUS

WITHDRAWAL

APPROXIMATELY MAXIMUM NUMBER OF DAYS FROM INITIAL ACTION TO EFFECTIVE DATE OF ORDER IS 370 DAYS

SPECIAL ASSISTANCE

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SPECIAL ASSISTANCE

1. Special Assistance

It is the examiner's responsibility to recognize problems early, thus preventing the need for Special Assistance, or at least minimizing the need for Special Assistance.

The need for Special Assistance arises when an operating insured credit union realizes a loss that cannot be absorbed as a part of normal operations and/or has the inability to operate in a positive income/expense position. All other supervisory solutions have usually been exhausted by the time Special Assistance is considered.

Special Assistance usually involves a workout plan, using all the tools available, to solve the financial problems of a federally insured credit union, while limiting the liability and the cost to the NCUSIF.

For the purposes of this chapter, Special Assistance is defined as any of the following actions or a combination of the following actions:

a. Authorization for special charges to the Regular Reserve and/or a reduction in the reserve transfer requirements of a federal credit union under section 116(b) of the Act and section 702.2(c) of the NCUA Rules and Regulations;

b. Assistance to an insured credit union to avoid liquidation under section 208(a)(1) of the Act.

c. Assistance to facilitate a merger or a consolidation of an insured credit union under section 208(a)(2) of the Act;

d. Assistance to facilitate the sale of all or of part of the assets of an insured credit union and/or to facilitate the assumption of all or of part of the liabilities of an insured credit union under section 208(a)(2) of the Act; and/or,

e. Authorization for a waiver of the Investment Valuation Reserve or other reserves that may be required of federally insured state credit unions under section 201(b)(6) of the Act.

2. Types of Assistance

More than one type of Special Assistance can be used in the development of a workout plan for an individual credit union. The following types of assistance are available:

a. Waivers and Charges to Reserves - The first source used to absorb losses is available reserves (required reserves and revocable reserves) in excess of full and fair

disclosure requirements. The regional office may require replenishment of required reserves.

In the case of state-chartered credit unions, the requirements of state law must be considered, as well as the opinion of the state supervisor. For example, if state law limits the use of the Regular Reserve to loan losses only, the Special Assistance consideration can use this reserve only to the extent that loan losses are involved in the request unless the state supervisor can override the legal requirement. Written approval for any override must be obtained. Any reserve required of state credit unions by agreement with NCUA under the authority of section 201(b)(6) may be waived as a part of or as all of a Special Assistance action.

b. Non-Cash Assistance - Most assistance granted beyond the use of reserves is the establishment of a Prior Undivided Earnings Deficit - NCUSIF Guaranteed Account. The account is established under the NCUA Board's authority to establish accounts in federally insured credit unions. In general terms, the account is used to record losses which exceed reserves and Undivided Earnings available to absorb them. In federal credit unions, the account is established after the Regular Reserve and the Undivided Earnings accounts have been reduced to zero.

Clearing of the Prior Undivided Earnings Deficit - NCUSIF Guaranteed Account takes place from future net earnings over a given period of time. Normally, the deficit should clear in a 2-3 year period to be a viable assistance alternative. Further, all net income goes to clearing the deficit before any rebuilding of reserves and Undivided Earnings. Net income should be sufficient to provide for the required reserve transfers even though all net earnings are applied against the deficit.

A deficit on the credit union's records means that fewer assets are available to earn money for operating expenses and dividends. As a general rule, it would be difficult to clear a deficit greater than 5 to 10 percent of assets in a reasonable period of time without some type of companion assistance.

c. Cash Assistance - In rare cases, cash assistance is considered from the Share Insurance Fund in the form of a capital note, a loan, a share account, or a purchase of assets.

Cash assistance in the form of a capital note is most frequently used. It is normally used in cases where the credit union is unable to operate in a positive income/expense position due to a drain on the income-producing ability of the credit union and when the use of a Prior Undivided Earnings Deficit - NCUSIF Guaranteed Account by itself would produce a deficit that could not be amortized in a reasonable period of time. Under this program, cash is advanced to a credit union in exchange for an interest-free, subordinated note. This cash infusion improves the credit union's earnings by allowing it to acquire income-producing assets to offset the impact of nonearning assets and/or accumulated losses. Capital notes are purchased subject to specific repayment schedules. Ideally, repayments should parallel increases in working capital generated by credit union operations from growth, asset restructuring, and funds generated from the assets acquired from capital note purchases, with the goal of maintaining or of increasing income as the cost-free capital notes are redeemed.

The Insurance Fund occasionally provides liquidity by extending an interest-bearing loan to a less-troubled credit union or by placing a share deposit in it. The Insurance Fund can also provide liquidity by purchasing certain types of assets. Fidelity bond claims are occasionally purchased whenever the event leading to the claim seriously drained the credit union's cash.

Liquidity assistance is normally not provided by the Insurance Fund. Liquidity needs are met from outside sources or within policy limits from the Central Liquidity Facility (CLF) if the credit union is a member. CLF protracted (long-term) loans can be used to assist credit unions with liquidity-related problems.

3. Mergers/Purchases and Assumptions (P&A)

A merger/P&A with or without special assistance is an alternative measure when it is not feasible for a credit union to continue operations. Every effort should be made to find a merger/P&A partner that will minimize any loss to the Share Insurance Fund and will allow service to continue to the field of membership. Mergers that solve a short-term exposure to the NCUSIF but have the potential of creating a long-term exposure to the NCUSIF must be avoided. Crucial to every merger is the ability of management to successfully deal with the problems existing in the merging credit union.

In a merger, the rights of members and creditors and the liabilities of the credit union are absorbed by the continuing credit union. The merging credit union is simply made a part of the continuing credit union. Accordingly, the continuing credit union must honor all legal commitments.

In a P&A, the purchasing and assuming institution purchases certain identified assets and assumes certain identified liabilities, including share accounts, of the credit union subsequent to the credit union's having been placed into liquidation. The P&A procedure cannot be accomplished unless members and creditors and the liabilities of the credit union cease upon its dissolution, i.e., liquidation, except to the extent such rights and liabilities are purchased or assumed as a part of the P&A. In a merger, liquidation of the merging credit union never occurs. This is a major distinguishing feature between the two procedures.

A merger can be accomplished only between credit unions. It is not statutorily possible to merge the operations of a credit union into a bank or a savings and loan association (S&L). However, it is a legal and, in some cases, a practical alternative to have a bank or an S&L be the purchasing and assuming institution of the assets and the liabilities of a credit union. Consequently, when necessary, NCUA can expand its scope of consideration to include banks and S&Ls.

Negotiations for any Special Assistance provided to facilitate a merger/P&A will start with the known and the estimated losses (estimated cost to the Share Insurance Fund) as of the effective date. The assistance amount will not exceed the estimated loss to the NCUSIF in the event of a liquidation as of the same date. Remember, a field of membership and deposits should be worth something to a continuing credit union. All assistance provided for a merger will be supported by a written agreement.

It is the district examiner's responsibility, working together with the credit union, the supervisory examiner, and the regional staff, to contact potential merger and/or P&A partners. The district examiner will not accept or express approval of any proposal without consent from the regional director. Final approval of every merger is the responsibility of the regional director or of the NCUA Board.

4. Requirements for Special Assistance

Before Special Assistance will be considered, the examiner must determine that the following requirements have been met:

a. The cause of the condition resulting in the need for assistance has been corrected. For example, if the assistance is needed to provide reserves to write off seriously delinquent loans, the examiner must support that lending policies/practices have been corrected and are sound, that an adequate collection program is in effect, that persons responsible for the past problems are no longer in positions of authority or that they have corrected practices, and that conditions in the field of membership being served are such that sound loans can be granted.

b. The management of the credit union must have the ability to direct and to control present and future operations. If not, they should be asked to resign.

c. The credit union must have reasonable prospects for sound future operations. Special Assistance is not a grant; it must be determined and supported that the credit union has the ability to amortize or to repay the assistance. In addition to earnings ability, it must be determined that the credit union has a viable base for future normal operations. If assistance is being recommended to maintain normal operations until a merger or a P&A can be arranged, the examiner must determine that this approach is less costly to the Share Insurance Fund than an immediate liquidation.

5. Workout Plans - Returning a Credit Union to Solvency

There is no single workout plan for the problems that are encountered in credit unions. Successful workout plans combine result-oriented management with result-oriented supervision. Activity without action and results is not acceptable. Only general guidelines are provided in this section, with some advice on things to do and some things not to do:

GENERAL WORKOUT STRATEGY

a. Establish basic credit union operations with current, accurate records and a very lean, functional organizational structure.

b. Establish the business strategy for the credit union in lending and in shares.

c. Outline the conditions for solvency within a maximum of 24 months and list the events that will have to happen for profitability and for solvency to occur.

d. Make the plan happen by doing it yourself or by making someone else do it.

e. Understand three "laws" governing workout plans:

(1) There are three factors you can change: income, operating expenses, and funds cost.

(2) There are two factors that must be understood by everyone: What the problem is and the urgency of resolving that problem.

(3) There is one factor that will determine success: management.

ADVICE - DOs AND DON'Ts

a. Do obtain a financial statement which breaks down each balance sheet item into yields and costs.

b. Do personally visit competing financial institutions and see what they offer.

c. Do obtain good resumes or job histories on management and on officials.

d. Do involve management people from other credit unions.

e. Do develop plans to become profitable within 1 or 2 months.

f. Do look for items that have an immediate impact on operations.

g. Do set up short-term "to do" lists so that immediate results can be seen - no matter how minor.

h. Do list actions accomplished on a weekly basis and set up actions to be accomplished for the next week.

i. Do set up short-term goals for the credit union to reach.

j. Do change the image of the credit union (clean up, fix up, make it look business like).

k. Don't keep studying when you already know your answer. Take action.

l. Don't argue pennies and theories.

m. Don't accept vague warnings without facts.

n. Don't incrementalize - (Example: if you need to cut employees, don't do it one at a time for a year; cut 10 or 15 immediately).

o. Don't have "sacred cows" that are exempt from review.

p. Don't wait until next time to get positive earnings.

q. Don't listen to people who tell you it won't work.

6. Resource Sharing

Resource sharing takes known, proven managers or other professionals and lets them become involved in resolving problems in the credit union. Examiners and regional office staff are able to call upon people who know how to manage and how to get operations moving and to bring them into troubled credit unions. The NCUSIF may pick up the cost of the resource people. However, the primary responsibility for such costs rests with the credit union. The examiner and the credit union should identify the particular problem or specific action that needs to be taken and the costs. Requests then flow through the regional director prior to commitment.

7. Letter of Understanding and Agreement

Special Assistance under section 208(a)(1) of the Act and use of reserves are always supported by a Letter of Understanding and Agreement (Agreement) signed by authorized representatives of the NCUA Board and of the credit union. Other forms of Special Assistance are supported by contracts or by other types of written agreements.

The Agreement or other contracts clearly set out the assistance offered as well as establish the terms and the conditions that the credit union must meet. The Agreement should be written in simple language so that all parties to the Agreement clearly understand what is expected.

Proposed Agreements are prepared by examiners or by regional office staff, as appropriate. The requirements depend on the individual case. A sample copy of an Agreement is attached. The actual Agreement should be tailored to the case.

8. Recommendation for Special Assistance

An examiner contact at the credit union will be made in every case to support a request for Special Assistance. The regional director will usually determine that arrangements for contacts of state credit unions will be made through state supervisors, if possible. The scope of the contact will also be determined by the regional director during discussions with the state supervisor. The scope will normally be limited to financial and management issues.

If the need for assistance is discovered during normal examination and supervision contacts, the examiner will not recommend Special Assistance to credit union officials until the case has been discussed with the supervisory examiner and the regional director has been advised. Once it has been determined to proceed with a recommendation for Special Assistance, the examiner or the regional office staff will work with the credit union officials and employees in developing a workout plan that addresses the entire problem and provides for correction and for return to normal operations within a

reasonable period. The recommendation will be submitted to the regional director. In all cases, the supervisory examiner's comments will be presented, either as a part of the recommendation or as a separate recommendation. The recommendation will summarize the type and the amount of assistance needed, the basic problem causing the need for assistance, and future prospects. The recommendation should include the following:

a. Most current financial statements;

b. Financial Performance Report (FPR);

c. Month-by-month analysis of the major balance sheet and income/expense items for the previous 12 months; and,

d. Budget for next 12 months.

9. Follow-Up

Regular supervision contacts will be made at credit unions provided assistance. Contacts of state credit unions will be coordinated with the state supervisor. During each contact, compliance with the Agreement will be determined. The examiner will also review the workout plan developed as a basis for the assistance to determine if any changes based on current conditions will improve the overall plan. Any recommended changes will be reported to the regional office, with supporting workpapers and documentation. Required reporting to the regional office is at the discretion of the regional director.

VI/
Charter No.

LETTER OF UNDERSTANDING AND AGREEMENT

To the Board of Directors and the Other Officials
******** ****** Federal Credit Union
Charter Number

The National Credit Union Administration Board (NCUAB), on behalf of the National Credit Union Share Insurance Fund (NCUSIF), has granted your credit union assistance to enable it to continue as an independent operation. This assistance was granted under the authority of sections 116 and 208 of the Federal Credit Union Act. Assistance outstanding as of ******* totaled

Subordinated Liability - NCUSIF
Prior Undivided Earnings Deficit - NCUSIF Guaranteed

Amortization of the Undivided Earnings Deficit - NCUSIF Guaranteed and repayment of the Subordinated Liability - NCUSIF are covered in paragraphs 2 and 3 respectively of this Letter of Understanding and Agreement. Other terms and conditions upon which this assistance will be continued are also covered in this Letter of Understanding and Agreement.

1. The ******** ****** Federal Credit Union agrees to provide for reserve transfers beginning with 5 percent of Gross Income for the quarter ending September 30, 1983, and 9 percent of Gross Income for the quarter ending December 31, 1983. Future transfers will be as statutorily required (Section 116 of the Federal Credit Union Act and the National Credit Union Administration Rules and Regulations, Part 702).

2. The ******** ****** Federal Credit Union agrees to reduce its Prior Undivided Earnings Deficit - NCUSIF Guaranteed at the same rate as the reserve transfers less loan loss expense in paragraph 1 above. All Net Income in excess of the required reserve transfer will also be used to reduce the prior Undivided Earnings Deficit - NCUSIF Guaranteed. The Prior Undivided Earnings Deficit - NCUSIF Guaranteed will not be any greater than the balance as shown below for any given quarter.

SAMPLE

MINIMUM REQUIRED AMORTIZATION PER QUARTER

Date	Amortization	Balance
June 30, 1983		$6,092,274
September 30, 1983	$207,274	$5,885,000
December 31, 1983	$409,000	$5,476,000
March 31, 1984	$460,000	$5,016,000
June 30, 1984	$465,000	$4,551,000
September 30, 1984	$470,000	$4,081,000
December 31, 1984	$475,000	$3,606,000
March 31, 1985	$476,000	$3,130,000
June 30, 1985	$481,000	$2,649,000
September 30, 1985	$486,000	$2,163,000
December 31, 1985	$492,000	$1,671,000
March 31, 1986	$493,000	$1,178,000
June 30, 1986	$498,000	$680,000
September 30, 1986	$504,000	$176,000
December 31, 1986	$176,000	$-0-

3. The ******** ****** Federal Credit Union agrees to repay the National Credit Union Administration the Subordinated Liability - NCUSIF in substantially equal quarterly installments of $500,000 each beginning September 30, 1983, with the final installment of $395,734 due September 30, 1986. The final $395,734 of repayments will be waived if the Prior Undivided Earnings Deficit - NCUSIF Guaranteed is fully amortized by December 31, 1985.

MINIMUM CASH REPAYMENT PER QUARTER

Date	Repayment	Balance
June 30, 1983	$500,000	$6,395,734
September 30, 1983	$500,000	$5,895,734
December 31, 1983	$500,000	$5,395,734
March 31, 1984	$500,000	$4,895,734
June 30, 1984	$500,000	$4,395,734
September 30, 1984	$500,000	$3,895,734
December 31, 1984	$500,000	$3,395,734
March 31, 1985	$500,000	$2,895,734
June 30, 1985	$500,000	$2,395,734
September 30, 1985	$500,000	$1,895,734
December 31, 1985	$500,000	$1,395,734
March 31, 1986	$500,000	$895,734
June 30, 1986	$500,000	$395,734
September 30, 1986	$395,734	-0-

4. The ******** ****** Federal Credit Union will declare and will pay dividends only from current period earnings.

SAMPLE

5. The ******** ****** Federal Credit Union will not, without prior approval or consent of the regional director:

a. Enter into new contracts or extend any existing contracts to:

(1) Purchase or perform services;

(2) Sell, purchase, or assign any credit union property.

Contracts for loans or shares with members or with permissible nonmembers are permitted provided they are within the financial ability of the ******** ****** Federal Credit Union.

b. Mortgage, pledge, or otherwise commit the assets of the ******** ****** Federal Credit Union to secure the borrowing of money.

c. Permit the creation or continuance of any other lien against the assets of the ******** ****** Federal Credit Union.

d. Make any loan or advance or extend any existing loan or advance, under any terms and conditions, to any director, officer, or management official or to their immediate family that is not routinely available to all members of the ******** ****** Federal Credit Union.

8. The ******** ****** Federal Credit Union agrees:

a. To provide to the regional director, within established time frames as applicable in the prescribed format, any and all information that may be requested.

b. To meet or to exceed all financial goals and schedules made a part of this Agreement including, but not limited to, the reestablishment of reserve requirements and the repayment of the Subordinated Liability - NCUSIF.

c. To keep the National Credit Union Administration informed of any major changes or of other significant events affecting the normal course of business and of operations.

d. That, should the credit union not meet any of the financial goals or schedules referred to herein or in any other manner not achieve satisfactory managerial, operating, or organizational progress, the National Credit Union Administration, under its authority in 208(a)(1) or 206(h)(1), may, at its sole discretion, add, change, or reduce board members and/or any management personnal as deemed necessary, and that the National Credit Union Administration may also, at its sole discretion, take whatever action is necessary to reduce the risk of loss to the NCUSIF including, but not limited to, selling all or selected assets, placing into conservatorship, merging, or liquidating the ******** ****** Federal Credit Union.

SAMPLE

Nothing herein shall prevent the National Credit Union Administration from taking any appropriate action, administrative or otherwise, that the National Credit Union Administration finds appropriate based upon the operations of the credit union or of the conduct of its directors, officers, management officials, employees, or any other person participating in the conduct of the ******** ****** Federal Credit Union's affairs.

9. The National Credit Union Administration Board and the ******** ****** Federal Credit Union agree that this Letter of Understanding and Agreement replaces and supersedes all prior Letters of Understanding and Agreement, as well as amendments thereto.

10. Except as provided by the early termination clause in this Letter of Understanding and Agreement, this Letter of Understanding and Agreement terminates June 30, 1987.

Dated this _____ day of ***** 19**.

NATIONAL CREDIT UNION ADMINISTRATION
BOARD ON BEHALF OF THE NATIONAL CREDIT
UNION SHARE INSURANCE FUND

_____
Regional Director

SAMPLE

We, the undersigned officials of ******** ****** Federal Credit Union, Charter Number ******, located in **********, **********, as authorized by the board of directors, acknowledge that the Special Assistance provided will be recorded as provided by this Letter of Understanding and Agreement.

This Letter of Understanding and Agreement has been voluntarily entered into with the National Credit Union Administration Board (NCUAB). We agree to comply with all the terms and conditions expressed in this Letter of Understanding and Agreement. If the NCUAB determines that these terms and conditions have not been complied with, the NCUAB may terminate this Letter of Understanding and Agreement. Termination will result in an immediate repayment of all cash assistance and the transfer of the Prior Undivided Earnings Deficit - NCUSIF Guaranteed to current Undivided Earnings.

The Special Assistance offered in this Letter of Understanding and Agreement will be withdrawn if the officials of this credit union do not execute this Letter of Understanding and Agreement within 10 days from the date of receipt.

********** ****** FEDERAL CREDIT UNION, BY:**

Date_____ _____
PRESIDENT

Date_____ _____
TREASURER

Date_____ _____
SECRETARY OF THE BOARD OF DIRECTORS

SAMPLE

SHORTAGES

SHORTAGES

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SHORTAGES

1. NCUA Responsibility

NCUA is responsible to all federally insured credit unions to provide guidance when a shortage is discovered. A shortage is any loss of funds or property belonging to a federally insured credit union caused by dishonesty (defalcation or embezzlement, robbery, and burglary). NCUA's responsibility to the member, creditor, and the NCUSIF includes bringing the shortage to a successful conclusion.

1.1 Examiner Responsibility

Examiners may be alerted to a shortage either by the credit union officials, by the regional office, or through the examination process. In any case, the procedures described in this chapter to protect the assets of the credit union during on-site contacts and to follow-up on the shortage are the examiner's responsibility as a part of district management. It is the examiner's responsibility to guide the officials in bringing the case to a close in the shortest time possible. In the past, examiners made detailed shortage examinations. This is not planned for the future.

Examiners should not approach an examination with the thought that a shortage may exist and that the employees or the officials may be dishonest. To do so would lessen the examiner's effectiveness and would reduce the opportunity to assist the officials in operating a sound credit union. However, examiners need to be alert at all times and, if there is any indication or evidence of a shortage, use every technique and resource available to determine whether a shortage actually exists.

Examiners should be cautious in what they say concerning the possibility of a shortage. Prior to confronting an individual suspected of a shortage, the supervisory examiner should be consulted. When a shortage is discovered, the examiner will determine that the Federal Bureau of Investigation (F.B.I.) and the local law enforcement authorities are notified. These agencies have the necessary expertise to investigate the case and to take the necessary statements from individuals.

2. Embezzlement

For purposes of the discussion in this section of the Guide, all internal shortages are combined under the general classification of embezzlement. These include all acts by officers, officials, or employees committed against the credit union for the purpose of diverting funds for their own benefit or use or to a third party who is not entitled to such funds. Embezzlements are the most common cause of shortages.

Larger losses often result from recurring acts of embezzlement that pyramid over a long period of time. Some of these ventures are well-planned and well-coordinated. Frequently, the techniques employed to cover discrepancies are relatively simple to

detect once the pattern is established. Sometimes treasurers or employees "borrow" small amounts. The first "borrowed" funds are often repaid, sometimes at the next payday. More often, the responsible person continues to "borrow" until the accumulated sums are far beyond the means to repay. The frequency of the "borrowing" often accelerates if the responsible person gets by one examination and/or audit without being detected.

Prior to current examination procedures, an examiner would find a small cash shortage during a cash count or an "I.O.U." in a cash fund. This could have been a "borrowing" activity by the treasurer or an employee and could be the beginning of a large embezzlement. If the examiner is informed of this activity by other employees or officials, it should be treated as a serious condition that deserves the attention of management.

Embezzlements resulting from misappropriation of funds or property from a federal credit union involve diverting funds before they are recorded on the credit union's records, as well as after they are recorded. Another type occasionally found is the diversion of funds realized from the sale of some asset owned or pledged with the credit union.

A partial list of methods used in embezzlement cases is included in Appendix A. Embezzlement warning signals are listed in Appendix B. Examiners should be familiar with each method and signal.

2.1 Initial Procedures

When the examiner discovers or is informed of a shortage, all the available facts should be obtained. The supervisory examiner should be contacted immediately and a course of action decided, including whether to make a contact if the examiner is not already on-site.

If the examiner and the supervisory examiner decide that the embezzlement is being properly handled by the credit union officials and the supervisory committee, a formal contact does not have to be made. This decision should be made after consideration of the risk to the NCUSIF. If a contact is not made, then the credit union should be instructed to formally notify the regional office of the circumstances surrounding the shortage and the examiner should establish a follow-up. The examiner should also provide the regional office with a brief memorandum of events which led to the decision not to make an on-site contact.

If the examiner is in the credit union already or it is decided to make an on-site contact, a variable scope examination should be completed if one has not been completed during the fiscal year. If one has been completed, regional policy on a follow-up examination or supervisory contacts will prevail.

2.2 Examination Scope

Regardless of the extent of the examination completed, it should be expanded as necessary to determine the facts about the alleged embezzlement. Once the pattern is discovered and documented, the examiner should leave the details to the supervisory committee to conclude. The examiner should not engage in needless audit steps which are normally the responsibility of the supervisory committee.

A Supplementary Facts section will be prepared. It will outline the facts, including, but not limited to, the responsible person, the method of embezzlement, the known amount, and the action taken by the officials to resolve the embezzlement. The examiner may wish to consult with the supervisory examiner prior to presenting the report to the officials. However, in any event, the Supplementary Facts will be limited to the "facts" known and verifiable. Suppositions and unsupportable conclusions will not be included in this section of the report.

2.3 Notifying Credit Union Officials

As soon as it is reasonably certain that a shortage involving embezzlement exists, the examiner should contact the chief executive officer and arrange for a meeting with the directors, urging them all to attend. If a special meeting is called without due notice, a waiver of notice should be obtained from all directors. The directors may invite members of the supervisory and the credit committees to be present.

The following should be accomplished during the meeting:

a. The directors should be informed of the evidence which indicates the existence of a shortage. If so desired, the responsible person should be given the opportunity to be heard.

b. The surety bond provisions relating to the termination of the bond on person(s) who have committed dishonest acts and the filing of a claim should be carefully explained.

c. The position held by the responsible person as an official or an employee should be declared vacant by the board. The examiner should, however, consider that this person may have a dominating influence on the board and must be firm in insisting upon vacating any bonded position held. The board also should appoint a person to fill the vacancy created by the removal of the responsible person, if possible. The responsible person, if an official, should not be present when the directors vote upon removal from office.

d. The examiner should make certain that the officials clearly understand their responsibilities to bring any records in arrears up to date and to complete an audit.

e. The officials should be informed not to negotiate with bonded persons or their agents for restitution. If restitution is offered, it should be accepted only upon the advice of legal counsel and only in cash to be credited to the accounts receivable account. If a check is offered, it may be accepted subject to collection. Any receipt

given should only acknowledge the amount and manner of payment and should not purport to be "in full payment." The acceptance of restitution should be made a matter of record in the minutes of a directors' meeting. If the responsible person is not covered by bond or if the total amount of the loss exceeds the bond coverage, the board should be informed that it is permissible to negotiate for restitution or to use any other course deemed advisable by legal counsel to recover the loss. If it appears that the loss will exceed the bond coverage, the credit union's salvage rights should be explained. If the question arises, the directors should be encouraged not to change sureties during the time a claim is being presented.

f. The officials should be cautioned against making any agreement, written or verbal, not to prosecute the responsible person in consideration of repayment or promise of repayment of all or a part of the loss.

g. The directors should be informed that publicity regarding a shortage is often harmful to the credit union and should be avoided in all possible cases. On the other hand, rumors can sometimes be more detrimental to confidence than the actual facts. If the question is raised, a special meeting of the members may be called if it is needed and the facts concerning the shortage are presented. Such a meeting will not be necessary or desirable in most cases. If reporters approach the directors, the officials should be cautioned not to violate the provisions of the bylaws relating to the holding of members' transactions in confidence. Discussion with reporters by the officials is often not desirable, at least until all the facts are available.

h. Other matters that the examiner will wish to consider bringing before the board are: changing of combinations or locks, changing signatures at banks or other institutions, stopping payment on checks that contain known forgeries, and pinpointing the responsibility of the person designated to maintain the records.

2.4 Removing Responsible Person(s)

Removal of the responsible person usually will be accomplished during the meeting with the officials. There will be occasions when the responsible person may voluntarily resign before the board meeting. The examiner should not hesitate to urge this person to cease handling credit union funds when the responsibility has been definitely placed. Additionally, the responsible person's share and loan accounts should be reviewed to capture shares to offset any loss and to take foreclosure or repossession action if the loan(s) is delinquent. Surety should be contacted prior to taking any action.

There may be instances when the directors are reluctant to remove the responsible person. This may happen when full restitution has been made. The examiner should insist on the immediate removal of the responsible person in all cases when there is obvious dishonesty. If necessary, it can be pointed out that failure of the directors to remove the responsible person may result in releasing the surety from further liability and that the directors may be held personally liable for losses sustained because of their failure to act. Also, the directors may be informed of the possibility of reinstating the responsible person if the surety company is willing to continue the bond. If the directors make a request for continued coverage, the examiner should ensure that all the facts surrounding the loss are clearly set forth in the notice. Where there is obvious dishonesty

or where the person is clearly incompetent, NCUA would probably take the position that the responsible person should not be returned to office even if the surety company should decide to continue coverage. The examiner should consult with the supervisory examiner before making any hard and fast decisions.

2.5 Notifying Surety Company

Arrangements should be made to send a letter to surety. The examiner may assist the person designated by the board to write the letter, although the responsibility is not the examiner's. A sample letter is included at the end of the Surety Bond section of the Guide. If the credit union officials refuse to notify surety, then the examiner should discuss the matter with the supervisory examiner. Should the supervisory examiner concur, the examiner should notify surety on behalf of the credit union. The sample letter at the end of the Surety Bond section of the Guide should be modified to fit the situation. Proof of Loss forms, in any event, should be forwarded to the credit union.

It is not necessary to know the exact amount of the shortage before giving notice of loss to the surety; in fact, a delay until the specific amount is known could jeopardize recovery from the surety company of the claim. The examiner should review pertinent provisions of the surety bond and refer to the Surety Bond section of the Guide before sending the notice of loss to surety. The surety bonds currently in use in credit unions differ in respect to the notice of loss provisions, so it is very important that the credit union's surety bond be reviewed.

Prior bonds that may have been in effect during the period of the shortage should be reviewed to determine if notice to more than one surety company is necessary.

Claims to surety should be submitted promptly once the audit and the verification are completed. Usually, there are time limits set by surety to submit claims. If it appears that claims will not be submitted on time, then an extension for filing should be requested. The officials are responsible for submitting the claims. The examiners should follow up with the officials to determine that the claims are promptly filed. A copy of the proof of loss should be submitted to the regional office.

2.6 Notifying the Federal Bureau of Investigation (F.B.I.)

Cases involving violations of federal criminal statutes are investigated by the F.B.I. and prosecuted by the local U.S. Attorney. It is the officials' responsibility to notify the local F.B.I. office, the U.S. Attorney, and the local law enforcement authorities of any shortage. Where criminal activity is involved, the notification will be accomplished by the completion and the submittal of a Criminal Referral Form, NCUA 2362 (Long Form) or NCUA 2363 (Short Form). Instructions for completion are on the forms and the examiner should determine that it has been completed and submitted. If the officials are reluctant to do this, then the examiner should contact the supervisory examiner. After discussing the matter with the supervisory examiner, the examiner will notify the F.B.I. or the appropriate investigative authority.

In emergency situations, which should be discussed with the supervisory examiner, it may be desirable to have the F.B.I. make an immediate investigation. Examples of such situations are when:

a. The responsible person has absconded;

b. There is danger of the responsible person disappearing, destroying the records, or concealing assets; or

c. Relatively large amounts are involved.

Generally, the examiner will not take a statement from a suspected person. This should be done by the F.B.I. or the local law enforcement authorities.

2.7 Establishing Accounts Receivable

An Accounts Receivable should be set up when the loss is determined. The account will remain on the credit union's records until the claim is paid by surety.

2.8 Supervision

The examiner should maintain contact with the credit union until the embezzlement is resolved. The type and the extent of these contacts will be determined by regional policy. District management dictates that the examiner should determine that the officials are promptly and correctly performing their responsibilities and duties. The Supplementary Facts should be updated at each formal contact until the embezzlement is finalized.

During the follow-up contact, the examiner usually will be able to determine what further instructions are necessary. Strengthening a credit union that has gone through a major shortage will sometimes present complex problems. A joint conference with the board and the committees may be desirable in order that the examiner will have the opportunity to review the progress made and to give additional instructions. Particular emphasis should be given to the work of the educational committee. Restoring the confidence of the members in their credit union is necessary in some cases. An active educational committee that works closely with the board can be effective in dealing with this problem.

In many cases, it will be necessary to conduct a complete supervisory committee audit to discover the extent of the shortage. The examiner will, to the extent necessary, contact the persons completing the audit to assure that it is progressing at a reasonable rate and that the data is being developed to proceed with any bond claim.

2.9 Contacts with Representatives of the Press

As a result of a shortage, the examiner may be contacted by the press for information. In dealing with reporters, the examiner should point out that the proper

source of information is the credit union's officials. The examiner is not authorized to give such information. If the reporter is persistent, the examiner should refer him to the officials of the credit union or to the regional office.

3. Burglary, Robbery, and Larceny

Normally, a contact will not be necessary when the examiner learns of a burglary, robbery, or larceny, except when the loss presents a material risk to the credit union and to the NCUSIF. If the examiner concludes that an on-site contact is necessary, the supervisory examiner should be contacted. The examiner will determine that the officials have taken the following steps:

a. Notified surety and made any claims.

b. Notified the Federal Bureau of Investigation and local law enforcement authorities.

c. Provided the regional office with pertinent information.

When an examination is made, all pertinent information will be placed in the Supplementary Facts.

4. False or Fraudulent Statements

Section 1014 of Title 18 of the United States Code makes it a federal crime for anyone knowingly to make a false statement or report, or to willfully overvalue any land, property, or security, for the purpose of influencing in any way the action of a federal credit union on any application, advance, discount, purchase, purchase agreement, repurchase agreement, commitment, or loan or any change or extension of any of the same, by renewal, deferment of action or otherwise, or the acceptance, release or substitution of security therefor.

Among the most common acts which would come under Section 1014 are forging of co-maker's signature on the note, false statements as to ownership or value of property offered as security for a loan, and false statements as to the purpose of a loan.

The officials should be cautioned that as much evidence as possible should be obtained in order to support the claim. A sworn affidavit from the person whose name was used is usually sufficient.

The credit union officials should use caution where they find that the name of a relative has apparently been forged on an instrument. Frequently these persons, in an effort to spare the responsible party additional difficulties, will claim that they gave permission for their names to be used. Consequently, in these cases, it would be difficult to prove that a loss had been sustained since the credit union could not proceed against the person who claimed that authority had been given for the use of the name.

If such a loss is covered by the bond, the surety should be notified by the credit union and, if a claim is to be filed, the examiner may assist in the preparation of the proof of loss forms while in the credit union.

The facts should be set forth in the Supplementary Facts during an examination. Sufficient information should be provided so that the regional office personnel may update their records as necessary.

4.1 Reporting Criminal Violations

The examiner should use extreme care in dealing with possible violations of Section 1014 of the U.S. Code. Incorrect statements as to ownership or value of property or incorrect statements as to the purpose of a loan may not necessarily represent a violation under Section 1014 unless they are knowingly made with willful intent to mislead the credit union. The examiner should contact the supervisory examiner with any doubt concerning an alleged violation.

Where a violation has occurred, the examiner should determine that the credit union has notified the F.B.I. If the board of directors declines to report a violation to the F.B.I., the examiner should contact the supervisory examiner for a decision as to how the violation should be reported.

5. Mysterious Disappearance

Losses may occur in federal credit unions through the mysterious, unexplainable disappearance or misplacement of property. Credit union blanket bonds usually cover losses of this nature either as a standard feature of the bond or as a rider to the bond. If a mysterious disappearance is discovered, the bond should be reviewed to determine if the credit union is covered.

Tellers' shortages are not covered by the bonds used by federal credit unions. The examiner will sometimes find that the credit union will treat such shortages as a mysterious disappearance or misplacement of funds and will attempt to claim them from surety. The credit union should be cautioned about filing many nuisance claims of this nature and be urged to file claims only when the amounts and circumstances are such that such losses are within the intent of the bond. One yardstick to be applied is that the loss of the funds must be clearly identifiable. For example, if the cash is short $100 at the end of the day, the surety contends that this is a teller's shortage and, therefore, not a claimable item. On the other hand, if member John Doe gave the treasurer $100 which is placed in a desk drawer and is later found to be missing, this is a mysterious disappearance.

5.1 Reporting Criminal Violations

A criminal act has not necessarily been committed when property mysteriously disappears. In some cases, however, the circumstances may be such that the officials may want to notify the F.B.I. and/or the local law enforcement authorities and to request

that an investigation be made. When the officials have not made this request and the examiner deems it necessary, a meeting should be called of the board of directors, urging them to take such action. Ordinarily, this step will not be taken without prior consultation with the supervisory examiner. If the directors should refuse to follow the examiner's recommendation, the examiner should again consult with the supervisory examiner regarding how to proceed.

6. Lack of Faithful Performance of Duty

The faithful performance of duty provisions of the surety bond cover a variation of losses from embezzlement to illegal disbursements. Claimable losses may result from honest errors or from willful acts. The first type may occur because of careless handling of cash, failure to maintain adequate records, or failure to perform some duty properly or in time when such failure results in a loss to the credit union. Erroneous postings or extensions given members, which may later result in their obtaining funds to which they were not entitled, are losses within the terms of the surety bond. Willful acts may represent embezzlement of funds for the benefit of the person committing the act or violations of the Act which cause a loss to the credit union even though the responsible person may not have derived a direct personal gain.

7. ATMs

ATMs are a new marketing device for credit unions as well as for other financial institutions. Besides convenience, there are dangers of vandalism and burglary and risks of internal and customer fraud. Credit unions may see more ATM fraud in the future if criminals learn how to circumvent the new technology. Since ATMs have to comply with Regulation E, this could limit a member's liability to $50. The credit union could stand to lose a lot more. Examiners will have to be alert to fraud in this area. All fraud cases must be reported to the regional office. The examiner should provide guidance to credit unions where needed or requested. Any difficulties should be discussed with the supervisory examiner.

8. Investment Fraud

During an examination, an examiner could encounter adjusted trading. Section 703.4(c) of the NCUA Rules and Regulations prohibits federal credit unions from adjusted tradings. This is prohibited because "full and fair disclosures" are not being met. If an examiner finds adjusted trading during an examination or is informed of it by other means, the supervisory examiner should be contacted for instructions. Adjusted trading is a means of hiding or trying to hide a loss on investments trading. A discussion on adjusted trading is contained in Section 6120.4, page 6-75 of the Accounting Manual.

9. Workpapers and References

9.1 Workpapers

(1) NCUA 2036 Supplementary Facts
(2) NCUA 2362 Criminal Referral Form (Long Form)
(3) NCUA 2363 Criminal Referral Form (Short Form)

9.2 References

(1) Federal Credit Union Act
 (a) Sections 107(6), 107(9)

(2) NCUA Rules and Regulations
 (a) Part 703 - Investments and Deposits
 (b) Part 702.3 - Full and Fair Disclosure Required

(3) Accounting Manual for Federal Credit Unions
 (a) Pages 4-59 thru 4-60

(4) CUNA Mutual Insurance Group
 (a) Stop ATM Crime
 (b) Credit Union Examiner Bond Guide

(5) Electronic Fund Transfer Act - Regulation E

APPENDIX A
Methods of Embezzlement

1. Withholding funds paid on shares, loans, interest, or U.S. Savings Bonds with no cash received voucher or entry in the Journal and Cash Record.

2. Withholding payments for shares and entrance fees of new members without opening accounts.

3. Withholding income from investments, such as U.S. Bonds or Savings and Loan Associations, without making an entry on the credit union records. Another method is using the income from these sources in place of cash payments by members and diverting the cash payments to the embezzler's use.

4. Substituting fictitious loan balances for payments received on loans actually granted. Payments are recorded only on the individual ledgers. To balance the ledgers control with the account, fictitious loan balances are set up on the subsidiary ledgers.

5. Transferring inactive share accounts to the responsible person's account for withdrawal while removing the inactive accounts from the ledger.

6. Using either fraudulent or previously paid invoices to support unauthorized disbursements.

7. Footing cash receipts or disbursements erroneously; also, falsifying records supporting Summary Journal and Cash Record entries, such as the Loans Transfer Summary used in Payroll Deduction Plan 2.

8. Forging checks and then destroying them when they are returned by the bank with the other canceled checks.

9. Removing cash from change funds or withholding receipts and balancing with an "I.O.U." or a personal check, which could not be paid by the bank because of lack of funds.

10. Delaying proper credit for receipts, known as "lapping." Lapping is the practice of withholding equivalent amounts of cash and cash received vouchers from the daily cash summary. Cash withheld is replaced with subsequent collections in a chain reaction until such time as the embezzler either replaces the "borrowed" cash or covers the shortage through some other manipulation of the records.

11. Omitting outstanding checks when the bank reconcilement is prepared in an amount which balances with funds withheld from deposit.

12. Issuing checks to fictitious persons and establishing fictitious loan accounts including forged notes and other documents.

13. Drawing checks for share withdrawals against a member's account and forging that member's name as the endorsement.

14. Diverting funds realized from the redemption or sale of U.S. Bonds, withdrawal of savings and loan shares, or the repayment of a loan by another credit union without closing the asset account.

15. Drawing checks in payment of personal expenses and charging them to credit union expense.

16. Reducing interest income by debiting interest and crediting it to credit union expense.

17. Falsifying dividend worksheets with improper entries in the records.

18. Overdrawing the responsible person's own share account.

19. Withholding recoveries on charged-off loans, received either directly by the credit union or through collection agencies.

20. Preparing fictitious life savings and/or borrowers' protection insurance claims.

21. Diverting proceeds of borrowings by the credit union and not recording the liability on the records.

22. Claiming that funds are in transit or in night depository at time of cash count. Responsible person makes up these funds either by borrowing or depositing a personal check, which may have no value.

23. Using two or more financial institutions to create a false impression that funds are available by means of kiting. As an example, a check is written on one bank in which there are no funds to cover a check in another bank. This in turn can create an endless cycle.

APPENDIX B
Warning Signals

1. Attempts on the part of the treasurer, the manager or an employee to postpone or delay the examination or the supervisory committee's audit.

2. General conditions of books and records unfavorable. Records not posted currently and/or out of balance for long periods of time.

3. Failure on the part of personnel to produce records for which they are responsible, or attempts on their part to delay access to records or cash on hand.

4. Extreme nervousness or evasiveness in answering questions by personnel during examinations and audits.

5. Failure of key personnel to share work or records with other employees. Attempts on the part of promoted employees to retain control of certain records because they "know the work."

6. Failure on the part of personnel to take vacations or attempts on their part to retain control over records during vacation.

7. Personal spending habits of employees in excess of the standard of living possible in relation to their visible income, often tipped off by heavy drinking, gambling, big cars, or expensive parties.

8. Personal checks or I.O.U.'s used to balance petty cash or change funds.

9. Bank records inadequately kept. No provision made for the reconcilement of cash received with bank deposits. Failure to deposit all collections "intact" so that they can be identified.

10. No receipts for cash transfers between the credit union office and field collectors or between employees in the credit union office.

11. Cash overages and shortages not recorded.

12. Missing notes, ledger cards, or records of past transactions, particularly canceled checks and member share and loan ledger cards.

13. Unusual and rapid increases in delinquent loans, without apparent accompanying causes such as strikes or layoffs, or long term delinquencies for which there is not a satisfactory explanation.

14. Unexplainable decreases in assets and in member share account balances at a time when the credit union should be growing.

15. Credit union expenses unreasonably out of proportion with gross income.

16. Loans to credit union officials, members of their families, or employees in excessive amounts.

17. Inadequate information on loan papers of credit union officials, members of their immediate families, and employees. Excessive delinquency for these loans.

18. High percentage of no-response accounts during positive account verifications mailed to the members' homes. Over a period of time, a pattern appears involving the same no-response accounts.

19. Verification letters returned to the credit union office instead of to the supervisory committee. Lack of control by the supervisory committee.

20. Failure of the board of directors to establish necessary and adequate control over operations.

21. Failure of the supervisory committee to perform comprehensive audits as required by law.

APPENDIX C
CUMIS Credit Union Discovery Bond

CUMIS Insurance Society, Inc., is the largest carrier of credit union bonds. It provides a basic bond called the Discovery Bond. It has varied at times with different types of clauses. The current bond is the 581.

The CUMIS Bond is a full discovery bond, which means, if a loss is discovered during the life or policy period of the CUMIS Bond, it is covered regardless of when the loss occurred, even if it was years ago. Likewise, no loss is covered if discovered after the bond is officially terminated, according to General Condition 15.

Who Generally is Covered?

All employees, collectors, members of the credit committee, supervisory committee, and directors, while performing acts coming within the scope of the duties of employees such as doing collecting, are covered. A director when performig the normal acts of a director is not covered. In addition, attorneys (appointed or retained), independent collection agencies, and data processors are also covered. (See "Employees" and the "Extension" under Definitions.)

What Losses Are Covered?

If the credit union suffers a loss arising out of the following circumstances, there is coverage: Fraud and dishonesty, lack of faithful performance, burglary, robbery, theft, mysterious disappearance, and forgery, including counterfeiting. Also covered are some miscellaneous coverages on loss due to fraudulent use of credit cards owned by credit union, truth-in-lending, loss or damage to equipment, food stamps. (See Insuring Clauses "A" through "H.")

Other Covered Expenses

Audit Expense - The audit expense incurred for preparing a proof for a valid and collectible loss under Insuring Clause "A," namely fraud and dishonesty or lack of faithful performance, is covered. This includes audit expense of state and federal examiners, league representatives, and CPAs.

a. The expenses of credit union salaried employees or committee members are not covered under audit expense. On occasion, upon request, expenses of these people in special situations are approved.

b. All the expenses of a regular examination by a state or federal examiner in which a loss is discovered are not covered, only the additional expenses attributed to proving the loss.

c. The audit expense payable is 50 percent of the paid loss up to the limits of liability.

Attorney Fees & Court Costs - The cost of defending a suit against the credit union which, if established, would constitute a payable loss is covered. CUMIS has a right to select the attorney. Other court costs, such as appeal briefs incurred in defending such a suit, are covered.

Some Items Not Covered

Property Not Owned by Insured - A member leaves a coin collection, jewelry, or other objects for safekeeping at the credit union and, in case of burglary or theft, there would be no coverage unless, before the loss, the insured or the credit union verified the value and maintained a record which showed this value and description.

Teller Errors - Exclusion (f) excludes: "Any loss due to teller's shortages." This is an expense of doing business and there will also be overages.

Interest Earnings - Exclusion (g) states: "Any indirect or consequential loss, including loss of use of Property or loss of earnings on Propery." Property is money. An employee embezzles $5,000 and, 1 year later, it is discovered. There is no interest payable on the $5,000 for the 1-year period.

Dividends - This is loss of earnings and excluded under Exclusion (g). However, coverage is provided for the dividend loss of a member where the dividend of the member is actually stolen or where the member sustains a dividend loss due to misappropriation of funds from a share account, and other members of the insured receive credit for their dividends.

Non-payment of Loan - A member obtains a loan from the credit union procured by fraud or false pretenses, such as furnishing false information on the application. There is no coverage unless, of course, forgery on the note was involved. The members and their acts are not bonded.

Employee's Personal Property - A credit union is burglarized and an employee's transistor radio is taken. There is no coverage. It would be covered under a homeowner's policy.

Robbery - Member or Employee Has Personal Loss - This is a third-party benefit and the limit is $100 per employee or member.

(For other losses not covered, refer to the Exclusions section of bond.)

Valuation

In case of stolen or damaged property owned by the credit union, the settlement is based on actual cash value at time of loss and not replacement cost unless the credit union also has Inland Marine coverage; then there is replacement with a $25 deductible.

For example, on a safe 30 years old damaged by burglars beyond repair, CUMIS would pay the actual cash value of the safe at the time of the loss. (See General Condition 3.)

Termination of Coverage

Employees - Under General Condition 9, coverage terminates as soon as the insured learns of a fraudulent or dishonest act of an employee, whether the act occurred while employed at the credit union or outside the credit union employment. For example, the credit union learns that an employee was dismissed at his previous place of employment for embezzling some company funds; the bond terminates immediately. It is to be reported to the bonding carrier and the carrier will decide whether or not coverage should be continued.

Liquidation - The bond terminates immediately upon the taking over of the business by liquidator, receiver, or governmental agency, federal or state. A regulatory agency, for example, may continue the bond coverage by applying for such coverage. (See General Condition 15 for detailed information on terminations.)

Notice and Proof of Loss

Notice should be given as soon as possible, but not more than 20 days after the credit union learns of the loss. Within 120 days after giving CUMIS notice, file an itemized proof. CUMIS then has 60 days to investigate the claim. Credit unions, not CUMIS, must prove their losses and, depending on the complexity of the loss, this proof can vary from a CPA audit to a short statement in case of a robbery or a burglary.

Subrogation

CUMIS, under the bond, has a subrogation or recovery right against the wrongdoer, whether it be a robber, if he/she can be located; an embezzler; an employee guilty of lack of faithful performance; etc. CUMIS has the same rights a credit union would have; in other words, CUMIS pays the claim and then takes the place of the credit union. Does CUMIS subrogate? Yes, recovery is attempted in all cases.

When is the Bond Claim Payable

Under the CUMIS bond, like all bonds of this type, there is no obligation of payment until the credit union has suffered a loss. For example, an employee makes a $2,000 loan to himself/herself with a duly executed note and a co-maker but had no authority - no approval by a loan officer or the credit committee - and the facts support a lack of faithful performance claim. However, the loan is current and the credit union has suffered no loss; so, for the present, no claim is payable.

BOND COVERAGE

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1.2 Endorsements and Riders

Bond companies issue endorsements or riders to the bond which add to, or delete from, the basic bond coverage. Examiners should carefully review any endorsements or riders that exclude coverage and determine if the endorsement or the rider reduces coverage below the minimum coverage in the approved bond form. If the examiner is not certain of the effect of the endorsement or rider, a copy of it should be sent to the regional office with an accompanying memorandum.

The following riders to Bond Form 23 were approved by the NCUA Board in January 1985:

a.	SR 5887d	-Credit Card Exclusion
b.	SR 5885	-Safe Deposit Box Exclusion
c.	SR 5512b	-Nuclear Exclusion
d.	SR 6026	-ATM Exclusion
e.	SR 5936d	-Extortion Exclusion
f.	SR 6035a	-Definition of Dishonesty
g.	Draft SR 5380a	-Faithful Performance Rider
h.	SR 6089	-Definition of Forgery
i.	SR 6064a	-Uncollected Funds Exclusion
j.	SR 6120	-Delete Trading Loss. This rider was approved contingent on its use in conjunction with SR 6121-Trading Loss Rider.

All these riders reduce coverage under the bond. Riders which reduce coverage provided by the basic bond must have the approval of the NCUA Board. Riders which add coverage under the bond do not need NCUA Board approval.

CUMIS submitted a new faithful performance rider to the 581 bond after the faithful performance requirement was reduced by the NCUA Board (see section 1.3). The rider (255-CDB-A417 (10-84)) was approved by the NCUA Board in November 1984. This new rider reflects the revised regulation, which requires faithful performance coverage of the financial officer only.

BOND COVERAGE

1. Bond Coverage

This chapter of the Guide will help examiners become more familiar with the bonds used by financial institutions and will help in the understanding of the coverage, exclusions, conditions, and other terms of credit union bonds. A discussion on the examiner's review of the surety bond during the examination is located at 7.5 of the Examination section of the Guide. Credit union bonds may be referred to as "fidelity" bonds, "blanket" bonds, "surety" bonds, "discovery" bonds, or other terminology. Whatever terminology is used, the bonds all provide the same type of coverage: primarily coverage against losses caused by fraud, dishonesty, theft, lack of faithful performance, and other similar activities.

1.1 Background, Requirements and Approved Bond Forms

The Federal Credit Union Act requires that the NCUA Board approve bond forms and prescribe minimum bond coverage. Section 701.20 of the NCUA Rules and Regulations prescribes the form and the minimum schedule of bond coverage. As a requirement of the Federal Credit Union Act, faithful performance coverage is required only of the board-elected financial officer. Fraud and dishonesty coverage is required of all employees and officials. This section also states that the NCUA Board has the authority to require a federal credit union to obtain additional coverage when the coverages in force are not adequate. The board of directors of each federal credit union is required to provide adequate coverage. Adequate bond coverage to assure proper protection of the members' shares may require coverage in excess of the prescribed minimums. The directors should review the extent of coverage at least annually. The board of directors should consider the credit union's loss exposure, risk control, and financial resources when determining the amount and the type of coverage necessary. Credit unions with limited internal controls should carry bond coverage in excess of the minimum set out in the regulation.

The following forms have been approved for federal credit union use:

Credit Union Form Number	Carrier
23	Various
576	Employees Mutual Liability Insurance Company of Wisconsin
577	American Casualty Company of Reading, Pennsylvania
580	Transamerica Insurance Company
581	CUMIS Insurance Society, Inc.
582	Cooperativa de Seguros Multiples de Puerto Rico

1.3 Faithful Performance and Fraud and Dishonesty Coverage

Section 112 of the Federal Credit Union Act requires the financial officer elected from the board of directors to give bond conditioned upon the faithful performance of the officer's trust. Section 113 of the Act requires any officer or employee having custody of or handling funds to be bonded. Section 120(h) of the Federal Credit Union Act requires bond coverage for losses due to fraud and dishonesty. Section 701.20 of the NCUA Rules and Regulations sets out bond and insurance requirements. Under the revised regulation, which is consistent with the requirements of the Federal Credit Union Act, faithful performance coverage is required only of the board-elected financial officer, the elected board member responsible for the duties set forth in Article VIII, Section 5, of the Standard Federal Credit Union Bylaws. All bonds approved for use by federal credit unions must contain a rider incorporating faithful performance of trust coverage for the financial officer of the federal credit union if such coverage is not included in the body of the bond. Although faithful performance coverage is required only of the financial officer, the coverage may be purchased for other officials and employees for an additional premium charge. In addition, all employees, directors, and supervisory and credit committee members must have fraud and dishonesty coverage.

NCUA believes that faithful performance provisions or riders of approved bonds cover losses resulting from the financial officer's negligence. In determining whether the financial officer acted negligently, acts should be compared to those of "prudent" credit union financial officers in credit unions of like size. The particular financial officer's intelligence, education and experience is not considered the "prudent" person test.

In some cases involving faithful performance coverage, bond companies have argued that the credit union's board of directors acquiesced to the negligent acts and that the claim was not payable. NCUA believes that, in order for a claim not to be paid based on board acquiescence, the following conditions must be present:

a. A majority of the board had knowledge;

b. They had full and complete knowledge;

c. They appreciated the illegal or nonconforming nature of the act; and,

d. There was no personal adverse interest.

1.4 Principles and Obligations for Surety Losses

Suretyship involves two obligations. First, there must be an obligation of the employee to the credit union. Second, the bond company has an obligation to the credit union, which comes into play when the employee breaches his/her obligation to the credit union. The main contract is between the employee and the employer credit union. If the employee has no liability to the credit union, the bond company has no obligation to the credit union. This is the equitable principle of subrogation, which distinguishes

suretyship from simple contracts and insurance contracts. (Insurance losses are discussed in section 1.5.) It means that the bond company (in this case acting as a surety) that pays the obligation of the defaulting employee to the credit union takes the place of the credit union. The bond company then has all the rights of recovery against the defaulting employee that the credit union had. Payment by the bond company does not extinguish the obligation of the employee; it substitutes the bond company for the credit union.

The credit union must comply strictly with the terms of the bond to recover from the bond company for direct losses of property. Notice of loss, proof of loss, and filing of suit against the bond company must be strictly in accordance with the bond or the credit union's rights against the bond company may be waived.

A credit union owes a duty of good faith to the bond company. This includes disclosure to the bond company of acts of employees, of which it has knowledge, which increase the bond company's risk. A credit union which has knowledge, not mere suspicion, of dishonest or improper acts of an employee and fails to tell the bond company of such facts may relieve the bond company of further liability.

Since the question of whether a reportable loss has occurred will often arise during an examination or supervision contact, the examiner will frequently be called upon to help the directors arrive at a decision as to reporting or giving notice of loss to the bond company, to the recovery of the funds, or to the filing of a claim. Decisions regarding these factors must be made by the board of directors. The examiner should guide the directors so that the credit union's interests under the bond will be protected. Directors could be held personally liable for losses suffered by the credit union when their failure to file a claim is unreasonable. If the directors should disagree with the examiner that an act should be reported or that a loss had occurred and that notice of loss should be given to the bond company, the examiner should follow the guidance provided in paragraph 2.5 of the Shortages section.

1.5 Insurance Losses

Most of the bonds authorized for use by credit unions contain insurance coverage for direct loss of property. These coverages protect the credit union against the direct loss of property because of such things as larceny, burglary, robbery, mysterious disappearance, and outside forgery and the damaging or the destruction of property due to these incidents. These are not all-inclusive and are not all included in each of the bonds. Under the insurance clauses of the blanket bonds, the credit union is not required to determine the identity of wrongdoers to recover losses as it must do to recover a loss of property caused by acts of its employees. The insurance portion of the contract is an agreement between two parties (unlike the surety contract, which is an agreement among three parties), whereby the bond company agrees to insure the credit union against any losses sustained under the applicable provisions of the bond.

1.6 Termination

Bond coverage for an employee (employee is defined in the bond to include various officials as well as credit union employees) is terminated immediately upon the discovery by the credit union of any past or present fraud or dishonest act committed by the employee. The bond company may terminate the bond as it applies to any individual by giving notice to the credit union.

The bond does not state that notice must be given when the credit union learns that an employee has committed a dishonest act. It states only that the bond coverage ceases as it applies to future acts of that individual upon the discovery by the credit union that a dishonest or fraudulent act has been committed any time, any place. "Discovery" can be interpreted to mean specific knowledge by a responsible person (manager, official, board member) in the credit union, not in collusion with the employee, that the employee committed a dishonest or fraudulent act at the credit union or elsewhere. The 581 bond has an additional termination provision which reads: "as soon as the Insured learns of a lack of faithful performance claim payment by any surety or insurer as a result of lack of faithful performance by such employee."

1.7 Covered Losses

The approved blanket bonds cover only direct losses of property. The credit union may suffer a financial loss through employee embezzlement, but it would not be covered under the bond unless it is a direct loss of property. For example, an employee steals $10,000. The $10,000 is a direct loss of property and is covered by the bond, but the interest income that the credit union might have earned on this $10,000 is not covered. The credit union would have suffered a financial loss but not a direct loss of property.

1.8 Claims Under the Bond

1.8-1 Reporting Illegalities

The credit union needs to inform the bond company of the facts in all cases where funds have been knowingly misapplied with the intent of violating the Federal Credit Union Act, the bylaws or the rules and regulations. The bond company should also be put on notice when funds of a material amount have been illegally disbursed even though the examiner is convinced that the act was inadvertent. The examiner should use caution in developing the facts and in making recommendations to the directors. The exercise of good judgment in making decisions in this respect is essential.

The purpose of reporting all the facts to the bond company in such cases is to protect the credit union in the event a claim is filed. A report to the bond company is necessary whenever any of the following illegal acts are found, especially if it appears

that the disbursement was knowingly made with the intent of violating the Act, the bylaws or the rules and regulations, or where the amount of the loan or the disbursement is material:

a. Loans of more than the legal maximum;

b. Loans with maturities in excess of the legal limitations;

c. Loans to persons not in the field of membership or to persons to which membership privileges have not been granted;

d. Loans to officials granted contrary to the provisions of the Act;

e. Loans in violation of the rules and regulations; and,

f. Share or share draft overdrafts of material amounts.

Loans for a few dollars more than the secured or unsecured loan limits or slightly in excess of the legal maturity limits may often be granted without knowledge or intent to violate the Act, the bylaws, or the rules and regulations. The examiner may find other similar unintentional violations. In these cases, the directors may decide not to notify the bond company. The examiner should call the board's attention to loans of this nature and obtain assurances that such violations will not recur. The minutes of the meeting at which the matter is considered should clearly set forth the decision of the board regarding notice to the surety.

A share overdraft may occur because of carelessness, inadvertence, or failure of a bonded employee to keep the accounting records current. Such overdrafts are usually unintentional and need not be reported. The credit union, however, should attempt to recover the misapplied funds. If it fails to do so, it would then have an obligation to notify the bond company of a loss and to file a claim.

Claims for small share or share draft overdrafts not arising from gross negligence need not necessarily be made to the bond company if the directors so decide. Where overdrafts of this nature are found, the examiner should encourage the officials to take steps to overcome the cause and to charge the balances to current expenses.

A share or share draft overdraft of an employee's/official's account, willfully and knowingly created by an officer, an employee, or a committee member is a dishonest act, not only on the part of the person who knowingly paid out the funds but also on the part of the officer, the employee, or the committee member who willfully diverted the credit union's funds. When both an overdraft and the responsible person are discovered, the examiner should recommend the suspension of the responsible person(s), since such an act causes the termination of the bond.

1.8-2 Possible Loan Losses Due to Lack of Faithful Performance

There is another type of loan, in addition to the illegal ones discussed in section 1.8-1, which can be classified as improper because of an omission or other failure to

perform a duty, without any dishonesty involved. These loans may result in a loss to the credit union. A notice should be filed under the terms of the bond unless prompt steps are taken which remedy the conditions which made such loans improper. Examples of what make such loans improper are:

a. Failure to record chattel mortgage or other lien instruments, when required by board policy;

b. Failure to obtain the security offered and approved by the credit committee or loan officer;

c. Failure to get proper credit committee or loan officer approval of loans or extension agreements or the withdrawal of encumbered shares;

d. Failure to get board, executive committee, or membership officer approval of membership application before making the loan;

e. Failure to obtain note or other evidence of disbursement; and/or

f. Granting loans for amounts and/or with maturities which exceed the stated policies of the board.

When the examiner finds exceptions of this nature, he/she should take prompt steps to correct the improper conditions. If such a correction cannot be obtained promptly (a period not to exceed 90 days should be reasonable) and the credit union sustains a loss because of a bonded employee's failure to properly perform assigned duties, a claim should be filed.

1.8-3 Acts Which May Terminate Bond Coverage -- Letter of Notification

One of the purposes of reporting serious breaches of faithful performance and/or fraud or dishonesty even when no loss has been suffered by the credit union is to determine whether bond coverage continues as it applies to a particular employee. If a loss has occurred or is likely to occur, then this notification may be combined with the notice of loss (see Section 1.8-4). There are instances where a breach may occur without a loss. For instance, the financial officer may knowingly make an impermissible investment. The investment may actually produce a profit rather than a loss for the credit union. Although no loss has occurred, the financial officer has committed a breach under the bond. This is the type of situation where the bond company must be notified even though there is no loss. It is the credit union's responsibility to furnish complete and accurate facts. Unless it does so, the bond company may later hold, legally and rightfully so, that coverage of the employee under the bond ceased at the time of discovery of the previous illegal or improper act.

When an act that requires reporting of the facts to the bond company is discovered during an examination or a supervisory contact, the examiner should recommend that a letter be prepared and mailed. If this report is not prepared before the examiner leaves the credit union, the facts to be reported to the bond company should be clearly set forth in the appropriate section of the examination report, usually

the Supplementary Facts, or in the memorandum covering the report of the supervisory contact. If a letter is sent to the bond company by the credit union, a copy should be obtained and attached to the examination report or to the supervision contact report. Instructions to furnish the regional office with copies of subsequent correspondence with the bond company should be given to credit union officials in the Record of Action section of the examination or the supervision report.

The following are the minimum essential items that should be covered in the letter to the bond company which reports serious breaches of faithful performance and/or fraud or dishonesty for the purpose of determining whether bond coverage continues on the person(s) responsible for such acts:

a. Description of the act;

b. Name and position of person(s) whose acts may have terminated bond coverage as it applies to them;

c. Specific law, bylaw, rule, regulation, and standard of conduct violated;

d. An explanation of the acts, which indicates whether the acts were fraudulent, dishonest, or unfaithfully performed;

e. Action taken to correct the act or acts;

f. Action taken to prevent recurrence of the act or acts; and,

g. Request to bond company for a statement of its willingness to continue bond coverage on person(s) whose acts are in question.

The examiner should recommend that the names of all responsible persons are specifically mentioned in the letter. Usually the bond of more than one person is affected in the case of illegal loans. For example, each of the persons who approved the loan application and signed the loan disbursement check might be held responsible in the case of an illegally disbursed loan.

The examiner may assist the officials in drafting the letter, but should keep in mind that it is the board's, not the examiner's letter. In most instances the letter of notification should be sent to the home office of the bond company, although one of the bonds currently in use permits notice to be given to any of the company's authorized agents. In the event the credit union refuses to notify surety, then the examiner should follow the guidance contained in paragraph 2.5 of the Shortages chapter.

1.8-4 Notice of Loss

The purpose of sending a notice of loss to the bond company is to put the bond company on notice that a claim may be forthcoming and to protect the credit union's rights to recover under the bond. Most bonds require that notice of loss be filed with the

bond company as soon as possible. The letter giving notice of loss in some cases may also contain a request that the surety inform the credit union as to whether bond coverage continues as it applies to the responsible person.

The letter notifying the bond company of the loss can usually be very short. It is not necessary to know the exact amount of the loss before giving the notice. In fact, a delay until the specific amount is known could jeopardize collection of the claim.

The following are the minimum essential items that should be covered in the letter to the bond company notifying it of a loss:

a. Statement that a loss has been discovered;

b. The amount of the known loss at the time of the notice;

c. Name, position, and address of the person(s) responsible for the loss;

d. Information as to whether the responsible person(s) have been removed from office; and,

e. Request for acknowledgment of the notice of loss, usually through submission of proof of loss forms, if a claim is going to be made.

An example of a typical letter of notice of loss is included at the end of this chapter.

1.8-5 Post Notification and Filing of Claim

Where illegal loans or similar illegal disbursements have occurred that require the reporting of the facts to the bond company, the credit union's officials have an obligation to recover an illegal share disbursement or to attempt to renegotiate an illegal loan. The examiner should advise the officials to renegotiate an illegal loan in those cases where it is obvious the borrower can repay the loan from income within the legal time limits. The directors should notify the person who has received the illegal disbursement. A formal letter, signed by the president or the secretary of the board, should be used in requesting repayment of an illegal share disbursement or in renegotiation of an illegal loan. If repayment of the illegal share disbursement is received or if the loan is renegotiated, the directors should notify the bond company so it can close the file regarding the potential claim.

When, for any reason, the illegal disbursement is not collected or the illegal loan is not renegotiated within the time limit for filing a claim as stated in the bond, a proof of loss form should be filed with the bond company. The credit union should be urged wherever possible to file its proof of loss within the time limit prescribed in the bond. Failure to file proof of loss within the prescribed time period may result in denial of the claim. The credit union should request an extension of time should it be impossible to file proof of loss within the prescribed period of time. The directors should be instructed in their responsibilities in this connection as well as in their obligation to follow through to see that the bond company respects its obligations under the bond. The bond company

has a certain number of days after the proof of loss is submitted to investigate the claim. Unless payment is received promptly, a firm reminder and follow up should be made. The examiner should inform the directors of the terms of the bond as related to the time limits within which suit may be brought.

When filing a claim, the credit union's officials have the obligation to furnish the bond company with a duly sworn itemized proof of loss. It is the credit union's responsibility to prove the loss, but proof to an absolute certainty is not required. The credit union is also obligated to cooperate with the bond company in its investigation.

Occasionally, the only means of collecting on the bond once a claim has been filed is to institute a lawsuit against the bond company. This suit must be filed within the time period prescribed in the bond. The credit union should, therefore, consult with its attorney when it becomes clear that the bond company is unreasonably delaying payment of the claim or has denied the claim.

1.8-6 Reportable Share and Loan Ledger Differences

It is not the policy of the Administration to have the credit union's officials inform the bond company about subsidiary share and loan ledger differences which create a loss, since ordinarily such losses will not be made the basis of a claim. In some instances, however, these differences might be indicative of an employee's overall failure to perform duties. Particularly where large, fluctuating differences are noted, the examiner may wish to inform the directors of the advisability of notifying the bond company and of determining whether the bond company wishes to continue coverage. Again, only the financial officer must be bonded for faithful performance. The negligence of other employees and officials may not be covered under the bond.

1.9 Bond Company's Obligation to Pay

The terms of the bond specify that the bond company has a certain number of days after a proof of loss is filed to investigate the loss. Unless payment is received within a short time thereafter, the directors should follow up and request prompt settlement. The bond company should not be permitted to delay settlement of claims for many months. If it denies a claim, it should do so promptly and advise the credit union of the reasons for the denial.

NCUA is of the opinion that a loss occurs when an illegal act has been committed and the credit union loses possession of its property as a result of the illegal act. If a credit union loses possession and control of its property as a result of an illegal act and makes reasonable and prompt attempts to regain possession of such property, but fails to do so, then a loss has occurred. Accordingly, such a loss is immediately claimable.

The examiner should keep in close contact with any credit union in the district that has filed a claim with the bond company. If the bond company should delay in making settlement of a valid proven claim, the examiner should urge the directors to follow up promptly.

SAMPLE LETTER TO BOND COMPANY

DATE:

Steinway Insurance Company
Any Town
Any State

Gentlemen:

Subject: Bond Number ____

An apparent loss as defined in the bond has been discovered during an examination by the National Credit Union Administration in the XYZ Federal Credit Union of This Town, This State. A preliminary investigation has disclosed losses amounting to $ at this time.

Mr. Martin Vezz, Treasurer, 334 Maple Street, This Town, This State, has admitted responsibility and his position has been declared vacant. He has not offered restitution.

Please send proof of loss forms so that a claim may be filed.

Sincerely,

President
XYZ Federal Credit Union

CHARTERING AND AMENDMENTS

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CHARTERING AND AMENDMENTS

1. Chartering and Expansions

The Administration's goal is to provide credit union services to as many groups of persons as possible who do not already have credit union service available to them. Each examiner is encouraged to promote the extension of credit union service to accomplish this goal by assisting in the chartering of new credit unions and the expansion of existing credit unions that comply with chartering policy and guidelines. Chartering guidelines for both new charters and expansions must be met. A significant factor in each case is the economic feasibility of the proposed action. New charters and expansions will not be approved if economic feasibility cannot be established. Examiner involvement should be coordinated with the supervisory examiner and the time spent consistent with the accomplishment of the primary goals of the region as specified by the regional director.

2. Volunteer Organizers

Volunteer organizers can provide valuable assistance in organizing credit unions. Examiners are expected to encourage and to assist local credit union leaders to become effective volunteer organizers.

Examiners should work with and train volunteer organizers so that they will be able to take a new group through all of the steps of chartering, organizing, commencing business, and developing a satisfactory operating plan. A volunteer organizer who has done the groundwork of stimulating credit union interest within a group should be encouraged to make the investigation and to sign the investigation report. Participation by the examiner in the volunteer organizer's first efforts will afford the examiner an opportunity to give the volunteer organizer any needed guidance and training.

Experienced volunteer organizers and credit union league personnel can make satisfactory investigations of groups interested in forming credit unions and can provide the guidance and assistance necessary to get the credit union into successful operation.

3. New Charters

The basic mechanics of organizing a new credit union are found in the Administration's publication entitled "Chartering Guide for Federal Credit Unions." This publication is available upon request from the regional office. Further clarification of chartering policy may be found in IRPS 84-1 and amendments thereto. Since the letter specifically allows for certain standards as determined by the regional director, no commitments should be made by the examiner until regional office approval is obtained.

Special assignments to investigate charter applications are frequebtly made. Proper evaluation of the group's potential is dependent upon the examiner's thorough investigation and candid reporting of findings. When a new credit union is chartered, the examiner will be notified promptly. The examiner should contact the newly chartered credit union as soon as possible but no later than the end of the second month after it is

chartered. The initial examination should be subsequently performed to comply with regional policy. The purpose of this contact is to determine that its books are properly opened, policies and procedures have been established, and operations are being properly conducted. Any problems that may be developing must be recognized, documented, and substantive corrective actions implemented.

4. Charter Amendments

Since section 5 of the credit union's charter is its legal authority to provide service to specific groups of persons, it is essential that it is appropriately worded. Officials may or may not recognize the need for field-of-membership revisions; therefore, examiner assistance is usually required.

Frequently, amendments to the charter are necessary because of a corporate change in the sponsor. This may result from a sale, or divestiture of a segment of the sponsor organization, or a merger of the sponsor with another corporation. In each instance, the credit union's charter must be revised so that it can legally continue to serve the original and, perhaps, new field of membership. In the event a corporate change results from the acquisition of another corporation that has credit union service, the acquired corporation is not automatically included in the field of membership of the acquiring corporation, notwithstanding charter language that may indicate otherwise. This type of situation must be discussed with the regional office.

When a corporate change takes place, often more than one credit union will be impacted. The most common problem is that the credit unions will have an overlapping field of membership. When this occurs, the credit unions should be encouraged to resolve the overlap among themselves. This type of overlap is generally unavoidable and no exception should be taken. However, caution should be exercised in periodically reviewing the overlap to determine whether a merger of the credit unions involved would provide better service to the members and would reduce the potential risks to the NCUSIF.

Economic factors may also dictate the need for a charter revision. This most often occurs when the credit union sponsor severely reduces its operation or closes completely. Action to expand the field-of-membership base after sponsor closure or reduction is generally too late and may ultimately compound the problem. However, depending on the circumstances and the location of the credit union, a charter amendment to include new groups should be considered. Ideally, if the sponsor is having financial difficulties, the addition of new, diversified, and strong groups should be considered when the credit union first discovers the potential problem. Specific criteria are delineated in IRPS 84-1, which must be satisfied when adding dissimilar groups.

Finally, expansions may be a result of the credit union's desire to increase its potential; that is, the credit union is not reacting to an immediate adverse condition. This type of expansion activity is encouraged provided the credit union is not trying to serve another credit union's field of membership. Again, IRPS 84-1 provides the criteria that must be met when adding dissimilar groups. When expansions of this nature occur, it is the Administration's policy to discourage overlaps and every effort should be made to avoid an overlap situation. On the other hand, credit unions must be sensitized to the

fact that having an identifiable group in their fields of membership does not create an irreversible franchise. The regional director is authorized to divest groups from a credit union's field of membership if the groups are not being adequately served.

5. Mergers

Mergers may be voluntary or may be the result of necessity. Unless the proposal is being considered under the emergency merger authority of the Federal Credit Union Act, chartering policies and procedures must be followed.

6. Bylaw Amendments

Bylaw amendments fall into two general categories. The first of these concern those portions of the bylaws relating to fields of membership. Article XVIII, section 2(a) of the bylaws contains the definition of family members. In NCUA Letter No. 73, boards of directors were granted authority to write their own definition of family members. The definition must be specific. A definition of family members by blood, marriage, or otherwise is not acceptable. Instructions for this amendment are contained therein. Another portion of the bylaws that applies to fields of membership is Article II, section 5. This is the authority concerning the "once a member, always a member" policy. The authority contained in that portion of the bylaws allows the board, by policy, to determine whether or not, and to what extent, it will avail itself of the "once a member, always a member" policy. A bylaw amendment is not necessary.

The second category of bylaw amendments deals with other phases of operational activities ranging from day-to-day operational procedures to elections and membership meetings. A number of optional amendments have been preapproved by the Administration and may be adopted by boards of directors without additional Administration approval or notification. Most of the preapproved amendments must be adopted intact. The only exceptions to this procedure are specifically spelled out in the instructions for adoption. Unless a bylaw amendment is adopted with the exact wording preapproved or within the limits prescribed in the instructions, it must be submitted to the regional director in writing for consideration.

Any bylaw amendment submitted to the regional director for approval must include the proposed wording for the entire section of the bylaws that contains proposed changes. The proposal should have the changed or added portions of the bylaws sections identified. This lessens the opportunity for inadvertent omissions or changes. The proposed changes should include justification for the proposals.

7. Regional Coordination

When charter amendments, mergers, or bylaw amendments involve groups in more than one region, the regional director receiving the original request must obtain the approval of the regional directors of all other regions affected.

8. NCUA 2170

The reverse of NCUA 2170, Examination Information, should be used to record any charter or bylaw amendments approved by the regional director or any preapproved bylaw amendments adopted by the board of directors during the examination period. For preapproved bylaw amendments, a determination should be made that the instructions for adoption have been followed. Numerous charter expansions to include select groups should be summarized. If an abbreviated form of charter amendment approvals is being used, the credit union's procedures and practices should be reviewed to determine their appropriateness.

MERGERS, CONVERSIONS, AND DIVISION

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MERGERS, CONVERSIONS, AND DIVISIONS

1. Merger Policy

Two or more credit unions, one of which is federally insured, may merge with prior approval of the regional director. The state supervisory authority (SSA) must also approve those mergers which involve one or more state credit unions with a federal credit union in those states where mergers of federal credit unions and state credit unions are permitted. NCUA staff should be aware that some states do not permit the merger of federal credit unions and state credit unions.

Mergers are usually for the purpose of continuing and/or improving service to members and, in some cases, of avoiding or of minimizing a loss to the National Credit Union Share Insurance Fund (NCUSIF). NCUA examiners should aggressively assist in locating merger partners and in developing the most advantageous plan which will avoid or minimize cost or risk to the NCUSIF.

1.1 Examiner's Role

The supervisory examiner, through the district examiner, is reponsible for all merger activity within the supervisory examiner group, commencing with determining that a merger is needed, finding merger partners, developing the most advantageous plan, and completing the merger after the regional director and the state supervisory authority (where appropriate) have approved the merger plan. Completion of mergers in a prompt manner after approval is usually in the best interests of the merger partners and the NCUSIF. Mergers involving only state credit unions where no financial assistance is needed will not require the attention of NCUA field staff unless specifically assigned. Mergers involving a federal credit union and a state credit union will need appropriate attention from the supervisory examiner to ascertain that the merger is completed promptly and in accordance with the merger plan.

Each district examiner must be aware of the status of all credit unions assigned to the district. This includes determining when there is a problem, or an emerging problem, that can best be resolved by a merger. In these cases, continued service to members and avoidance of unnecessary risk or loss to the NCUSIF are the paramount considerations. Proper analysis of these conditions in their early stages will almost always avoid losses to the NCUSIF. Each of these potential merger candidates should be thoroughly discussed with the supervisory examiner so that the most appropriate action can be considered, decided, and executed. Through this course of action, the necessary time requirements and utilization of available resources can be approved and coordinated.

In developing merger plans, the examiner should be aware of the merger procedure requirements outlined in the Credit Union Merger Procedure and Merger Forms, NCUA 4301, or other applicable documents provided by the regional office and in Part 708 of the National Credit Union Administration Rules and Regulations. While NCUA 4301 provides many sample forms for use during a merger, the examiner should be

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aware that these are suggested forms and not necessarily required as long as an acceptable merger plan can be developed between the merger partners. Flexibility and innovativeness are essential elements of any merger plan.

Where the examiner learns of a merger of convenience between two partners, necessary assistance should be provided in the preparation and the submittal of material to the regional director and in the actual completion of the merger. Where merger action is necessary to avoid or to minimize a loss to the NCUSIF, the examiner should aggressively determine that merger partners are promptly located and plans are developed to achieve the desired objective (avoiding or minimizing a loss to the NCUSIF). This objective can best be achieved when there is completion among potential merger partners.

Where waiver of the membership vote is necessary to avoid or to minimize the loss to the NCUSIF (see Section 708.6 of NCUA Rules and Regulations), the examiner should determine that data to support the waiver request is submitted. In all such cases, the examiner should also provide a recommendation on the request.

When the merger has been approved by the regional director and the state supervisory authority, where appropriate, the necessary supervisory attention and/or pressure must be provided by the examiner to insure a prompt completion of the merger. This prompt action is especially imperative in cases where financial stability, membership confidence, and service are in jeopardy and in all cases where any financial assistance by the NCUSIF is being provided. The examiner's responsibility in all of these cases continues until the charter and/or the share insurance certificate of the merged credit union is cancelled.

2. Charter Conversion Policy

A federal credit union may convert to a state-chartered credit union. Most state statutes also permit state-chartered credit unions to convert to a federal charter. In those state where the state statute is silent, the state supervisory authority generally has promulgated administrative procedures to permit a conversion. In all cases, the state supervisory authority must endorse the conversion proposal. A state credit union which is not insured under the NCUSIF converage converting to a federal credit union will also need to meet insurability requirements before the charter application can be approved.

2.1 Examiner's Role

A federal credit union converting to a state credit union must comply with the provisions of Section 125 of the Federal Credit Union Act, including the obtaining of the majority approval of the members who have voted on the proposal. Upon compliance with the provisions of Section 125 of the Federal Credit Union Act, and the proper reporting of these facts, the federal credit union must comply with the provisions of the state's statutes and regulatory procedures of the state in which the credit union is located. Once the federal credit union makes its decision on conversion known, the examiner should cooperate with the group to enable it to complete the conversion process at the earliest reasonable time.

Examinations of state credit unions converting to federal credit unions will be at the discretion of the regional director. These examinations, when performed, will utilize standard NCUA examination procedures, unless otherwise assigned, and will be completed before NCUA approval of the conversion is given.

State credit unions converting to a federal credit union charter must comply with all state requirements and file the necessary application for charter and application for insurance, where appropriate, with the regional office.

3. Insurance Conversion Policy

When a credit union submits an application to convert to federal insurance coverage, the initial review of the application will be conducted in the regional office. If it is determined that an on-site review is necessary, further guidance will be provided to staff by the regional director.

4. Division of Assets, Liabilities, and Capital

In rare cases, a federal credit union may need to consider an equitable division of its assets, liabilities, and capital and to form a second credit union.

The legal requirements and the procedure to follow in effecting divisions are discussed in Part 709 of the NCUA Rules and Regulations. The examiner will need to ensure that the officials understand and comply with these requirements. The proposed plan for division will be submitted to the regional director.

4.1 Examiner's Role

If the regional director's review of the proposed plan for division and the supporting information indicates that the proposal is reasonable, the examiner will be assigned to make the necessary charter investigation of the group to be divided. If the requirements of the proposed plan and other requirements established by the regional director are met, the examiner will assist in holding the charter-organization meeting for the new federal credit union and in completing the charter and the insurance applications.

When the charter and the insurance certificates have been issued, the examiner will assist the officials in recording the division on the credit union's records. The examiner will assist the officials by providing guidance on the many technical matters involved in a division. Upon completion of the division, the examiner should determine that the required final reports are submitted to the regional director. The regional office will coordinate the division of the NCUSIF capitalization funds with the Department of Insurance when the division has been completed.

LIQUIDATIONS

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LIQUIDATIONS

1. Liquidations

In order to carry out that part of district responsibility which relates to liquidations, the examiner must have a thorough knowledge of the three types of liquidations and the procedures which govern each. Liquidations are classified as follows:

a. Voluntary - Where liquidation is undertaken with the approval of the members and is conducted by the credit union (Part 710 of NCUA Rules and Regulations). Procedures which the credit union will follow in the conduct of the voluntary liquidation are contained in the Voluntary Liquidation Procedure for Insured Federal Credit Unions, NCUA 8040. The examiner must play an active role in the supervision of a voluntary liquidation in order to expedite the liquidation while protecting the interests of the creditors, the members, and the NCUSIF.

b. Involuntary Under Title I (Section 120) - Where the NCUA Board orders involuntary liquidation for reasons other than insolvency or bankruptcy and appoints the Liquidation Specialist or an examiner as Liquidation Agent. Although there is no specific manual which governs this type of liquidation, the procedure for winding down operations will generally be in accordance with the voluntary liquidation procedure. The major difference is that NCUA will conduct the liquidation instead of the credit union and will be responsible for the collection of loans, the distribution of shares to members, and the accounting thereof. Involuntary liquidations under Title I do not involve NCUSIF.

c. Involuntary Under Title II (Section 207) - Where the NCUA Board deems the credit union insolvent or bankrupt and appoints itself as Liquidation Agent. Liquidation specialists or examiners will serve as agents for the liquidating agent and will conduct the on- and/or off-site liquidation and payout functions in accordance with the Liquidation and Payout Procedure, NCUA 9700.

2. Voluntary Liquidations

Responsibility for determining that the voluntary liquidation is conducted in accordance with prescribed procedures rests with the officials or, where applicable, with a designated liquidating agent. The examiner's role is to ensure that the credit union officials or board-appointed liquidating agent comply with the instructions outlined in the manual.

Supervision contacts will be made monthly throughout the liquidation. These contacts need not be on-site if sufficient information is available by mail and by telephone to enable the examiner to properly monitor the conduct of the liquidation. The examiner's duties will extend into such areas as:

a. Counseling the officials on the decision to liquidate;

b. Exploring the possibility of a merger with another federal or state credit union;

c. Coordinating the sale of loans and other assets;

d. Monitoring the solvency of the credit union;

e. Effecting the prompt submittal of reports to the regional office and determining their accuracy; and,

f. Bringing the liquidation to a prompt conclusion.

Voluntary liquidations remain the district examiner's responsibility until the charter is cancelled.

2.1 Considering Liquidation

Frequently, the examiner will be consulted for advice on whether liquidation is advisable. Careful analyses of all pertinent conditions will be required to learn the true reason for the officials' consideration of liquidation. The examiner will expend reasonable effort to prevent unnecessary liquidations.

Some causes for liquidation for which there may be practical solutions are: withdrawal of support by the parent organization, delinquent loans, lack of interest on the part of the officials, difficulties in finding replacements for key officials, or disputes between officials or factions within the credit union.

Reorganizing the official staff, revamping the operating procedures, and reviving interest among the officials and members may be indicated. Their accomplishments will depend upon the examiner's ability to make use of the facts uncovered in the investigation. The examiner may arrange to have a meeting of the members, a conference with representatives of the parent organization, and enlist the aid of league officials or other local credit union leaders if there are indications that one or more of these steps will be helpful. The supervisory examiner should be kept posted as to the progress in resolving the problem.

2.2 Alternative to Liquidation

All alternatives to liquidation should be explored. Among these should be the extension of the basic field of membership to result in a viable group, such as conversion from an occupational to a residential or associational type charter.

In some cases, a merger with another federal credit union under regular chartering policy or with a state credit union will be possible. Merger is definitely preferable to liquidation since credit union service can be continued for those who would otherwise lose it. The examiner should investigate the possibility of a merger and include all pertinent findings in a memorandum to the regional office. For instructions

on a merger, the officials should be directed to the procedures outlined in Part 708 of the NCUA Rules and Regulations.

Under certain conditions, the regional director can provide assistance in the merger and can reimburse the continuing credit union to prevent a loss as the result of merger. Commitments to the credit union(s) should not be made concerning such assistance. Before deciding upon recommending assistance, the examiner should consult with the supervisory examiner.

2.3 Commencement

The commencement date of liquidation is the date the board votes to submit the question of liquidation to the members. If, for some reason, the examiner feels this date would not result in an equitable distribution to the members, contact should be made with the supervisory examiner to decide upon appropriate action. The regional director has the authority to change the date of liquidation in order to provide for equitable treatment of all members.

An example of inequity would be the case where borrowers were induced to transfer shares to current loans just prior to the announced decision to propose the question of liquidation to the members. By reducing the base for determining the liquidating dividend, a larger dividend would be accorded a select number of shareholders. Inequity would also apply to the situation where, just prior to liquidation date, members with large share accounts were persuaded to withdraw under the misconception of a prolonged period of waiting for final distribution.

The cash basis rather than the accrual basis of accounting should be followed during liquidation. Procedures outlined in the Accounting Manual should be followed, except that income and expense accounts are not closed at year-end.

2.4 Examiner Present

In those cases where the examiner is present at the commencement of liquidation, a copy of the voluntary liquidation procedure should be given to the board of directors and the regional office should be advised accordingly. The examiner should ensure that the officials understand the prescribed procedure for carrying out the voluntary liquidation and should urge the officials to take all necessary steps to properly protect the members' interests and to complete the liquidation as rapidly as possible. Normally, the liquidation period should not exceed 1 year. After analyzing operations, the examiner can usually determine if certain problems are likely to develop and how they can be resolved. Any suggestions that are pertinent should be given to the officials for their benefit in carrying out their responsibilities. If a liquidating agent is to be appointed, the examiner should determine that the board of directors is specific in the delegation of the agent's authority. The board should be encouraged to retain as much responsibility as possible and delegate only necessary authority to the liquidating agent; however, if the board decides to delegate its total authority, its action should be explicitly documented in the minutes of that meeting.

In those cases where the solvency of the credit union is questionable, the examiner should discuss the authority of the liquidating agent with the board with respect to receipting for consenting to administrative action under Title II, Section 207. If total authority has been delegated, the liquidating agent could address the involuntary actions. Otherwise, such authority must be specifically spelled out in the appointment. The examiner should be reasonably sure that the Liquidation Agent is qualified and will devote the time necessary to wind up the liquidation in the shortest time possible.

2.4-1 Closing Books

The examiner should determine that the books are closed as of the date the board votes to submit the question of liquidation to the members, using the same procedures that are followed at the close of an accounting period. If at all possible, commencement reports and schedules should be prepared in accordance with the voluntary liquidation procedure and submitted to the regional office while the examiner is still present at the credit union. If the reports and the schedules cannot be prepared and mailed during the contact, a firm date will be agreed upon when these items will be completed and mailed. The examiner will follow up by telephone or other means to determine that the agreement was kept.

The examiner may suggest that the board of directors authorize late charges to be levied on inactive share accounts under $5, as provided by the bylaws, prior to closing the books. Also, out-of-balance conditions should be resolved at this time, where possible.

2.4-2 Insolvency

While the examiner is present at the commencement of liquidation, the question of solvency must be decided. If the credit union is insolvent or likely to become insolvent, the examiner should recommend to the regional director that the credit union be placed into involuntary liquidation under Title II, Section 207, of the FCU Act. (Section 700.1(k)(i) of the NCUA Rules and Regulations defines insolvency.)

The examiner's memorandum should demonstrate the insolvency, supported by current financial statements and a delinquent loan list. Actual cash value should be determined for each asset account. Assets assigned a cash value less than book value should be discussed in the memorandum along with the reason(s) for the valuation. The delinquent loan list should be marked to indicate the classified loans. Current loans which are possible losses, such as bankruptcies, should also be reflected on the list as classified.

It is not a condition of payout that the officials request the payout or indicate their willingness to consent to the contemplated involuntary action. Insolvency is the determining factor. However, the examiner should explain to the officials the obligation of the share insurance fund and that the recommendation is intended to be in the best interests of the members. Usually, the officials will recognize this and cooperate by making advance preparations to facilitate a payout.

In certain rare circumstances, a credit union may experience a liquidity problem which may prevent it from making a prompt share distribution. This may occur, for example, where the bulk sale of a loan portfolio has been temporarily delayed. In such cases, 208 Assistance may be considered to assist the prompt payment of members' shares. Prior to discussing such assistance with the officials, the examiner should contact the supervisory examiner.

2.4-3 Items to Stress

While the examiner is present, the items discussed below should be stressed with the officials so as to expedite the liquidation and to protect the members' interests.

Since the duration of the liquidation usually depends upon the collection of loans, the examiner should emphasize that a bulk sale of loans will shorten the liquidation period and that a more favorable price might be negotiated early in the liquidation. The possibility of selling the loans at a favorable price to certain organizations or individuals should be explored. The examiner's ability to bring the buyer and the seller together can be a significant contribution to a prompt conclusion of the liquidation. The officials should be reminded that if the sale of the loans or other major assets will not produce sufficient funds to pay off the shareholders at par (100%), no sale may be consummated without the written approval of the regional director.

Credit unions which need assistance in selling a loan portfolio may contact the appropriate regional liquidation center for marketing assistance.

While the bulk sale of loans will, in most cases, be the practical way of hastening distribution to shareholders, the examiner should not encourage the officials to sacrifice the loan portfolio at an inequitable discount, especially if the credit union is financially sound and loan collections will pose no particular problem. Under these conditions, the board may wish to continue to collect the loans for the purpose of providing the shareholders with a liquidating dividend. These liquidations should usually be completed in less than 18 months.

The officials should be reminded that the auditing responsibilities of the supervisory committee do not cease because the credit union enters liquidation. Rather, the need for control is more pronounced since operations are directed to converting all assets to cash and since sole responsibility for the liquidation is frequently delegated to one individual.

The matter of surety bond coverage requires special consideration because of the accumulation of cash. The examiner should determine that the officials are aware of coverage requirements as provided by Section 701.20 of the NCUA Rules and Regulations and that they arrange to continue bond coverage for at least 4 months beyond the date of final distribution.

The treasurer or the liquidating agent should be reminded of the importance of prompt submittal to the regional office of monthly financial and delinquency reports, as well as other requested reports.

Once the determination has been made that the credit union will be able to return member shares at par, the regional office will request that the credit union's NCUSIF capitalization deposit be returned to the credit union.

The officials should be informed that if final distribution is not started by December 31, the annual operating fee for that year is due. For the purposes of assessing operating fees, the final distribution will be considered to have been made when the general distribution of checks for confirmed accounts has been made.

2.5 Follow-Up During Liquidation

The examiner should plan out-of-town contacts in conjunction with other work in the area so as to avoid, if at all possible, making a trip on a per diem status solely for the purpose of supervision. The credit union should be given ample advance notice so that the officials can prepare for the examiner's visit by having the records current and in balance and by arranging their schedules to allow for meetings with the examiner. The examiner will also need to prepare for the contact by reviewing the file and setting objectives of the contact.

The purposes of such contacts generally will be to determine:

a. That records are being maintained current and in balance;

b. Whether or not the credit union is solvent;

c. The estimated completion date of liquidation;

d. Any further action needed to expedite the liquidation;

e. That any applicable operating fee is paid;

f. That the prescribed procedures and previous instructions given to the treasurer or the liquidating agent are being followed;

g. That a majority of the members have approved the liquidation within 90 days from the date of the board's decision (ordinarily, necessary only at first quarterly contact);

h. That passbooks or signed confirmations of members' accounts are on file for all members who can be located, so as to minimize the number of trusteed accounts at completion of liquidation; and,

i. Compliance on the part of the supervisory committee, as applicable.

An inspection of the records will be necessary to determine the above and provide direction on the conduct of the liquidation.

Unadjusted differences between the Individual Share and Loan subsidiary ledgers and their respective control accounts should not be permitted to delay distribution. If most of the accounts have been confirmed and the differences are reasonable, the examiner may suggest an arbitrary adjustment of the control accounts. Instructions from the supervisory examiner should be requested if the amount of differences is material.

In certain instances, services of the league or the local chapter may be used to advantage in disposing of unused supplies and outstanding loans and in other ways which will advance the date of the distribution to the shareholders. In some states, the leagues have specialized personnel and services for assisting with liquidations. The credit union may accept assistance from the league if it wishes to do so. If the examiner determines that the credit union is insolvent, the instructions in subsection 2.4-2 of this section apply.

If the officials are still in charge, a joint conference should be held with them at the conclusion of the contact. Any exceptions or irregularities should be discussed with the responsible officials and appropriate steps should be taken to assure necessary corrections. If unsatisfactory practices are jeopardizing the interests of the shareholders and the share insurance fund, the examiner should ensure that the officials discontinue these practices immediately. The examiner should not hesitate to recommend the replacing of an incapable liquidating agent.

2.6 Partial Distribution

The examiner occasionally will receive inquiries concerning partial distributions. Policy is not to encourage partial distributions if the liquidation is not expected to extend beyond 6 months. However, there will be cases when a partial distribution is appropriate. Partial distribution generally should be at least 25 percent of total shares, and any subsequent partial distribution normally should not be less than 25 percent of commencement shares. Before a partial distribution can be made, the credit union must first request permission from the regional director. The reports which should accompany this request are outlined in the voluntary liquidation procedure.

2.7 Reports During Liquidation

Each supervisory contact on a liquidation will be covered by a memorandum to the regional office. The memorandum should briefly state the conditions found and any instructions given, including agreements reached; should furnish any information specifically requested by the supervisory examiner; and should give the anticipated date of distribution. The memorandum covering the first quarterly contact should state the date that the majority of the members approved the liquidation.

The examiner should be aware of the requirement that each credit union in liquidation must send a copy of its financial reports and the delinquent loan list to the regional office promptly after the end of each calendar quarter. During each contact, the examiner should check to see that the credit union has complied with this requirement. If the reports have been delayed, this should be brought to the attention of the treasurer/liquidating agent and a firm commitment obtained that the reports will be

sent timely in the future. If the reports for the previous quarter have not been submitted, they should be included with the memorandum. The examiner should continue to check on the credit union even after final distribution has been made. The liquidation is not concluded until the final reports have been submitted to NCUA and the charter has been cancelled. Frequently, the follow-up on final reports can be by telephone, except that on-site contact should be made when the examiner feels that the credit union will not of its own initiative prepare and mail the final reports, or whenever the examiner suspects there will be undue delay on the part of the credit union in winding up its affairs.

2.8 Resumption of Operations

The board of directors has the authority to rescind its action to present the question of liquidation to the members anytime before a majority vote by the members in favor of liquidation is obtained. It must resume operations if approval by a majority of all members is not obtained within 90 days of such decision of the board to seek such approval. If the examiner learns that the officials plan to resume operations under either of the above two conditions, the regional office should be alerted. The examiner will also contact the board and remind it that a plan to overcome the adverse conditions which caused the board to initially consider liquidation must be submitted to the regional director.

2.9 Insolvency During Liquidation

If the credit union becomes insolvent at some point during the liquidation, the instructions contained in subsection 2.4-2 of this section apply.

3. Involuntary Liquidations

Another chapter of the Guide explains Administrative Actions and the related procedures for placing an operating credit union into involuntary liquidation under Title I (for reasons other than insolvency or bankruptcy) or for placing an operating credit union into involuntary liquidation under Title II (for reasons of insolvency or bankruptcy). Once the Order of Involuntary Liquidation is served upon the credit union, the discussion in this section of the Guide applies.

Although Title I provides that a federal credit union may be placed into involuntary liquidation because of insolvency, Title I does not provide for a related payout. Therefore, all orders of involuntary liquidation because of insolvency or bankruptcy will emanate from Title II, Section 207. Regardless of the Title used as the authority for issuing the Order of Involuntary Liquidation, the charter of the credit union is first suspended under Title I.

3.1 Title I

When a federal credit union is placed into involuntary liquidation under Title I, Section 120, the region is responsible for converting the assets to cash, for making distribution to members, for preparing final reports, and for acting as custodian of records. In all cases, liquidation specialists or examiners will serve as liquidating agent. The liquidating agent has the authority to hire assistance deemed necessary for the liquidation upon the regional director's approval. The cost of wages or salaries for outside assistance is an expense to the credit union.

A formal appointment letter signed by the regional director will be sent to the agent. Any special instructions will be in a memorandum accompanying the appointment letter.

Except as required in Section 120 of Title I, the same procedure will be followed in an involuntary as in a voluntary liquidation, or as otherwise specified by the regional director.

3.2 Title II

Effective October 1, 1984, involuntary liquidations will be handled by either of two regional liquidation centers. Federally insured credit unions in Regions I, II, and III will be processed by the center in Region II (Capital). Federally insured credit unions in Regions IV, V, and VI will be processed by the center in Region V (Austin). The liquidation center will normally not be involved in any action until the recommendation to place the credit union into involuntary liquidation has been determined and approved by the regional director. At that point, the liquidation center will be notified and on-site procedures will then be coordinated from the center.

As explained previously, procedures for requesting an administrative action against an insolvent, operating credit union are outlined in another chapter of the Guide. Frequently, however, it will be necessary to initiate an administrative action against a liquidating credit union because of insolvency or bankruptcy. Basically, the instructions in the Administrative Actions chapter of the Guide dealing with an operating, insolvent credit union apply also to a liquidating, insolvent credit union, except that, in the case of the liquidating credit union, it is not necessary to cite any other charges except insolvency in the examiner's recommendation to the regional director for the administrative action. The agent will be furnished with the Notice of Revocation of Charter and Involuntary Liquidation for delivery to the officials. It is necessary that the Order be served upon an official and the accompanying Certificate of Service be signed. If the examiner either cannot locate an official or the available official(s) are unwilling to sign the Certificate, the agent for the liquidating agent should be contacted immediately. In such cases, it may be necessary for the examiner to prepare a notarized affidavit detailing the efforts made to serve the Notice. In addition, one copy of the Notice should be sent via certified mail to the most current mailing address of the highest-ranking credit union official.

A formal appointment letter signed by the regional director will be sent to the agent. Special instructions from the regional director regarding the examiner's role

during the on-site phase of the liquidation will be in a memorandum accompanying the appointment letter.

3.3 Payout in Insured State Credit Unions

When an insured state-chartered credit union is declared insolvent or bankrupt by the appropriate authorities, the insured accounts of members of that credit union will be paid by the NCUSIF. When the NCUA Board is appointed liquidating agent, NCUA will handle the liquidation in addition to payout. Liquidation specialists and examiners will be called upon to serve as agents for the liquidating agent. State examiners will often participate in the on-site phase of the liquidation.

Administrative actions on the part of NCUA are not applicable with a state credit union payout, nor does the NCUA make the determination of insolvency. However, a formal appointment letter signed by the regional director will be sent to the agent. Special instructions from the regional director will be in a memorandum accompanying the appointment letter. NCUA's procedures will be followed to the extent they do not conflict with state law.

3.4 Preparing Credit Unions for Liquidation

The primary goals of an involuntary liquidation are to provide for a prompt return of members' shareholdings and a prompt disposition of the assets of the credit union. For these reasons, once the decision has been made to place the credit union into liquidation, it is important that the credit union's records be current and in balance. Prior to placing the credit union into involuntary liquidation, the examiner should take efforts to ensure that:

a. **General Ledger** - Records should be current and in balance with the respective control accounts. Individual accounts should be analyzed and identified.

b. **Individual Share and Loan Ledgers** - Records should be current and in balance with the General Ledger.

c. **Bank Reconcilements** - Records should be current and in balance. All reconciling items should be identified and analyzed.

d. **Bond Claims** - All claims should be documented and any follow-ups or proof of loss extensions filed to protect the credit union's interests.

e. **Insurance/Surety Bond Premiums** - Premiums and related insurance reporting requirements should be kept current in order to ensure continued coverage.

f. **Loan Portfolios** - Documentation on loans should be reviewed to ensure that all required documentation is on file and liens or other security documents have been recorded or otherwise perfected in order to protect the credit union's interests. Missing documents or signatures should be obtained as necessary.

4. Failure to Commence Business - Newly Chartered Federal Credit Unions

When the regional office receives notice that a new group will not be able to start operations, an assignment may be issued to the examiner to determine whether the credit union should be placed into liquidation. Efforts should first be made to find a solution to the problem that is holding up operations. If it is determined that the credit union will not be able to commence business, the examiner should obtain and forward to the regional office the following:

a. The original Charter and Share Insurance Certificate issued to the group; and,

b. A letter or statement signed by at least a majority of the directors and including the following:

(1) Request for Revocation of Charter;

(2) Reason for not beginning operations;

(3) Statement to the effect that no business has been transacted; and,

(4) Information as to the disposition of the initial supplies.

4.1 Examinations of Liquidating Credit Unions

In general, it is NCUA's policy not to make examinations of liquidating credit unions either during or at the conclusion of the liquidation. When necessary, however, assignments for examination will be issued by the regional office. While regular examination techniques will ordinarily be followed, the scope of the examination will be determined by the regional director. The examiner will be guided by appropriate instructions issued by the regional office to the examiner.